

THE DISSOLUTION OF THE BRETTON WOODS SYSTEM

EVIDENCE FROM THE NIXON TAPES

AUGUST – DECEMBER 1971

by

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ABSTRACT

In July 1944, representatives of the Allied nations gathered in Bretton Woods, New Hampshire and signed an agreement to rebuild the international monetary system. From 1946 until August 15, 1971, major currencies were fixed to the US dollar, and the dollar was, at the same time, convertible to gold at the rate of \$35 per ounce. On August 15, 1971, without consulting the leaders of the rest of the world, Richard Nixon made the decision to end convertibility of the dollar into gold and allow the dollar to float against gold and world currencies.

The Nixon tapes, the series of personal recordings made during the presidency of Richard Nixon and since made public, provide a unique opportunity to determine why the administration made the decision in this way. The tapes also provide unique insights into the reactions of the rest of the world following this decision and how the negotiations that rebuilt the system of international finance took place. It has become clear from these tapes that economic outcomes were subordinated in favor of political issues, as the Nixon administration viewed the renegotiation of the system of international finance as an issue of national security. The primary concern of the administration was always the 1972 election, and that overshadows the economic theory that surrounded the decisions being made.

Chapter 1

INTRODUCTION

While the political abuses of the administration of President Richard Nixon are well documented, the complex economic decisions made by the administration are not well understood. Nixon vastly reshaped the economic landscape through his New Economic Policy (NEP), but these policies were not necessarily instituted to foster long-term economic growth. Literature on political business cycles has existed for over thirty years, but evidence of the existence of such phenomena is mixed¹.

The Nixon tapes, the personal tape recordings made under the orders of President Nixon, suggest that Nixon's economic decisions in 1971 were designed to create favorable economic outcomes in the lead-up to the presidential election of 1972. These tapes provide evidence detailed in this paper that Nixon pursued international trade and monetary policies with little concern for their repercussions beyond his reelection in 1972.

¹ Abrams and Butkiewicz (2007)

Chapter 2

INTERNATIONAL MONETARY CRISIS

In August 1971, the Nixon administration faced an international monetary crisis. The Bretton Woods system, established in 1945, was crumbling. Under the Bretton Woods system, the US dollar was pegged to the value of gold at the price of \$35 per ounce. Most of the world's other currencies were then subject to fixed exchange rates with respect to the dollar. Growing concerns over rising current account (Table 1) and government (Table 2) deficits in the United States drove investors away from the dollar and encouraged purchases of gold. Gold outflows, as depicted in Table 3, began in the second quarter of 1970 and continued in earnest until the fourth quarter of 1971.

Nixon was very much aware of the fact that the US dollar was overvalued, and as gold outflows continued, it became apparent that the United States would not have enough reserves to maintain convertibility. Political pressures, however, caused Nixon to have reservations about ending convertibility and devaluing the dollar relative to the price of gold.

The gold situation was only part of the full spectrum of economic concerns that plagued Nixon in the lead-up to the 1972 election. He was also concerned about slowing domestic growth and employment, as well as the specter of inflation. Nixon heavily pressured Federal Reserve Chairman Arthur Burns to increase the money supply and foster economic growth (Abrams, 2006). In addition to

pressures on monetary policymakers, Nixon sought to deal with the domestic and international economic concerns with the additional aspects of the NEP.

It has become clear through the Nixon tapes that Nixon was primarily concerned with short-term economic outcomes. The need to deal with the monetary crisis was secondary to the election of 1972. In fact, it seems unlikely that Nixon would have dealt with the monetary problem had he not been convinced by his advisors that the issue could be made politically expedient.

Ultimately, the monetary issue was dealt with on August 15, 1971 with the introduction of the NEP. The NEP introduced a ninety-day freeze on prices and wages, a tax credit for investment in new equipment, acceleration of the schedule for increasing personal-income-tax exemptions, and the repeal of a seven percent excise tax on automobiles to deal with the domestic concerns (Abrams and Butkiewicz, 2007). To deal with the international monetary crisis, the President announced a suspension of the convertibility of dollars into gold and a temporary tariff surcharge of ten percent on all imports regardless of country of origin. The decisions regarding the international situation were made in close consultation with several of Nixon's chief economic advisors, including Treasury Secretary John Connally, Office of Management and Budget Director George Shultz, and Council of Economic Advisors Chairman Paul McCracken². The decision, was not, however, made in consultation with any foreign leaders who would certainly have had a vested interest in the outcome. Why would Nixon make such a consequential international economic

² These three advisors, along with Federal Reserve Chairman Arthur Burns make up the Quadriad, Nixon's primary economic team. Arthur Burns, as noted by Abrams, was marginalized by Nixon. His marginalization will result in tensions as the exchange rates are renegotiated, as is developed below.

decision without consulting with his international colleagues? Evidence from the Nixon tapes suggests that Nixon sought to maximize his political impact through secrecy, and Connally used the famous paranoia of the President to prevent negotiation. Again, political expediency is paramount, and Nixon is convinced by Connally that making a unilateral decision will be a show of leadership that will prove useful in the 1972 election.

The grasp of Nixon and Connally on international trade theory is tenuous at best, and the subsequent conversations between the two, particularly as the administration renegotiated the dollar exchange rate between August and December, confirm this fact. Initially, Nixon focuses only on the domestic implications of the decision to suspend convertibility and implement “the surcharge”, as the 10 percent tariff comes to be known. As negotiation develops, Nixon sees the issue of convertibility not as an economic concern, but as an issue of national security. Connally and National Security Adviser Henry Kissinger become the two primary emissaries of economic policy for the administration.

From an economic standpoint, the currency crisis made the suspension of convertibility necessary. Nixon himself, however, was opposed to the concept of a surcharge except in conjunction with a potentially unpopular decision like suspending convertibility. This fact, coupled with the political intrigue which surrounded the renegotiation of exchange rates, temporarily terminating with the December 18, 1971 Smithsonian Agreement, which reestablished a system of fixed exchange rates that operated until 1973, (Bordo and Eichengreen, xvii) demonstrates Nixon's desire to manipulate short-term economic outcomes for political gain.

Chapter 3

THE DECISION MAKING PROCESS

As noted above, Nixon's advisers were aware that the ongoing outflows of gold evident in Table 3 would necessitate action by the administration. As early as June 8, 1971, Shultz and Nixon discussed a conversation that Shultz had with economist and unofficial administration adviser Milton Friedman³. Friedman, who would later tell economist Peter Bernstein in approbation of the latter's commitment to freely floating exchange rates, "Yes, pegs lay eggs and eggheads create pegs" (Friedman and Schwartz, xviii), supports the idea of floating the dollar relative to gold and other currencies. Free floating is never truly discussed as a reality by the administration in the period from June to December 1971. It is suggested in the conversations that follow that the dollar be floated against select currencies. The following tapes provide support for the hypothesis that Nixon made the decision to suspend convertibility and add a ten percent surcharge according to political motivations.

August 2, 1971 (Conversation Number 553-6) Nixon with Connally and Shultz. White House Chief of Staff H.R. "Bob" Haldeman enters later.

Nixon is initially meeting with just Shultz, when Connally enters. Shultz and Connally acknowledge the exigency regarding the international monetary crisis.

³ Nixon tape conversation No. 514-8.

Shultz: “Sometime in the next day or so, John, if we could talk about this international monetary business...”

Connally: “I think we have to.”

Shultz suggests that Nixon convene a meeting of the Quadriad to deal with the economic crisis. After Shultz leaves the meeting, however, Connally implies to Nixon that Shultz is not properly informed about the crisis. Connally is a lawyer and former Democrat, not an economist, though he is being coached by his deputy, Undersecretary of the Treasury for International Monetary Affairs, Paul Volcker, and he shrewdly manipulates Nixon throughout the process to maximize his own political impact. Some months later, Nixon will acknowledge to Counsel to the President John Ehrlichman that he knew that Shultz, a well-respected economist, was more of an expert on the issue of convertibility than Connally⁴.

Connally continues to stress just how important it is to stop the gold drain. Connally: “In the international field the problem is one – the convertibility of dollars into gold and we're going to have to stop that at some point...Everybody, I say 'everybody', most people tend to think that ten billion dollars [in gold reserves] is the point below which we should not go.”

Much later in the conversation, Nixon and Connally are joined by Haldeman. Connally and Haldeman detail just how serious the gold drain has become. Haldeman notes that the United States has lost \$850 million in gold reserves in the week of August 2, 1971 alone. Connally continues that the French have called in over \$1 billion in reserves in the past few weeks and that the Germans and the Dutch are looking to call in some \$200-250 million more. Connally thinks that the President

⁴ Nixon tape conversation No. 601-33

could hold on a decision until mid-September, but not later. Nixon wants to hold off on his decision for two major reasons. First, congress is in recess, and he wants to limit the political backlash of making a decision while congress is not in session. Second, Nixon understands little of the nature of the international problem, and wants to hold off on making a decision until he can properly gauge the short-run effects. Nixon would prefer to wait to move on the issue of convertibility after the 1972 election for obvious reasons. Connally tells him that the US will likely lose an additional \$3 billion in reserves within a year.

Connally: "I don't believe you can hold the position through the elections next year. That being true, I don't think you'll ever be forced to take a position."

Connally may tell Nixon the economic truth, but he couples it with pure pandering, thus accomplishing nothing.

Connally's simplifications of the issue do little to resolve Nixon's confusion.

Connally: "We can stop convertibility very easily – by just saying so...The next thing is that you probably ought to float this exchange rate with the other currencies of the world. Just like Germany's doing with us now. We have a floating currency – like Canada's doing with us now⁵. We can take these steps without revaluing gold."

Connally seems to believe that somehow convertibility can be ended and the dollar can be devalued against other world currencies, all the while maintaining the

⁵ In late July, both Canada and Germany ended the pegs between their currencies and the dollar, effectively breaking the Bretton Woods system before the United States, but neither the mark nor the Canadian dollar served as a reserve currency, so the August 15th decision remains considerably more consequential. Neither country could maintain their current account imbalances with the United States, and were forced to float their currencies to resolve them.

gold price of \$35 per ounce. Simple economic theory dictates that if the dollar is no longer freely convertible into gold, and is no longer pegged to other currencies with fixed gold prices, that the dollar price of gold will change as well. Connally seems not to fully understand the gold situation, and as is noted later, doesn't feel that the decision necessarily has to be made right away. Volcker disagrees. Volcker bends Connally's ear about the urgency of the situation, and, finding him not wholly receptive, is suspected by Nixon as the source of a recent *Wall Street Journal* article detailing a "tremendous crisis" on the international monetary front.

Nixon: "It's probably that goddamn Volcker."

Haldeman suggests that Volcker is trying to force the closing of the gold window without building a consensus within the administration. Volcker, a respected economist, is likely the force behind Connally's knowledge of the gold situation, but as a Democrat, he is unable to build the necessary coalition as long as the President is talking about him as "that goddamn Volcker."

Nixon, Connally, and many of the administration advisers place heavy emphasis on the psychological effects on the nation of ending the dollar's relationship with gold.

Haldeman: "What bothers George [Shultz] the most is closing the gold window. He's worried about you having to campaign as the President who devalued the dollar."

Connally, however, sees a bright side, recognizing that devaluation will increase demand for US exports.

Connally: "Posture it as being competitive."

Furthermore, Connally proposes bundling the end of convertibility with a ten percent surcharge, as well as domestic actions in the form of a wage-price freeze. He suggests “taking domestic steps to strengthen the dollar.”

Connally: “Whatever we do in the international field – it seems to me – ought to be coupled with action on the domestic front so that they tend to shield each other.”

Connally notes that Shultz disagrees with coupling, but he has already told Nixon that Shultz doesn't fully understand the situation. If such an action is taken, and ultimately, it is, Connally promises “no political downsides. At all. And a great deal of upsides.”

It is at this point that Connally suggests the idea of a surcharge to accompany the suspension of convertibility. He proposes a ten percent import tax until “such a time that we renegotiate the exchange rate.” He promises that this policy would have no downside. There are few things about which the majority of economists agree. The single truth about which economists agree most is that barriers to trade have significant economic costs. The economic costs of a tariff tend to be broadly spread, thus resulting in limited political costs. While Nixon is an avowed supporter of free trade⁶, he says, “the import duty delights me,” showing that he too grasps the positive political externalities of such a decision. With a growing Balance of Payments deficit a significant issue, Nixon and Connally may have seen the surcharge as a way to reduce that deficit, an argument that Nixon would use to defend the surcharge after its implementation.

Connally also defends the wage-price controls as a way to “shield” the psyche of the American people. He also makes the still-common distinction between “Wall Street” and “Main Street.”

⁶ Nixon tape conversation No. 576-8

Connally: “What the [wage-price control] does is it quiets this country down. Now we're taking some very aggressive action. We're floating the dollar...For the first time we're not gonna convert dollars to gold. Now that's not going to affect the average fella, but it's damn sure gonna affect financial markets. I don't know if it's gonna do it adversely. It'll be a helluva shock to 'em.”

Connally shows remarkable political savvy, but little knowledge of economics. The affects of this decision on financial markets is predictable. Importers will be affected adversely, which exporters could predict greater sales overseas as the dollar is devalued. And the devaluation most certainly affects the “average fella” - though he may not fully understand the repercussions, which then would not directly affect Nixon's reelection bid.

The political upsides that Connally mentions are an attempt to stroke Nixon's ego. Long-run economic outcomes are of little concern, only short-run political gain matters.

Connally: “[This] ought to show people that you're aware of the problems in the foreign and domestic fields and that you have the courage to face up to it. [You] take a position before you're forced to.”

He goes on to promise Nixon that the decision to end convertibility “could be as big a coup as [Nixon's] China thing⁷.”

So it is established that economic concerns were not paramount in Nixon's decision making process, but why did the administration choose to make the decision

⁷ Nixon's July 1971 announcement that Henry Kissinger had secretly visited Beijing during a scheduled trip to Pakistan, the first step in the eventual normalization of US relations with the People's Republic of China.

regarding the international monetary situation without consulting the rest of the world? The answer lies in Connally's political manipulations and Nixon's infamous paranoia. Connally tells Nixon, "I talked to the Vice President of Dow Chemical who just spent three weeks in Europe who's smart as hell." He warns Connally of the European Finance Ministers' Meeting which is set to take place the last week in September, at which the Europeans intend to issue a statement regarding the United States' role in the international financial crisis.

Connally: "He says they're going to try to come up with a common front against the United States and a common front against the dollar."

He continues to draw on Nixon's paranoia, reminding Nixon of the International Monetary Fund and World Bank meetings set to take place in Washington, DC in early September.

Connally: "With the press here [garbled] they're going to try to leave the impression that all of their problems are because of the dollar and because of the policies in the United States."

Nixon is skeptical, and asks Connally if there is any point at which the British, the French, the Germans, or the Japanese can be included in the negotiation. Connally's answer is complex, both establishing and contradicting an air of economic knowledge. Initially, Connally tells Nixon that he will be "entrapped" by the foreign leaders that he tries to include. He follows this statement by establishing that hinting at an upcoming end to convertibility will exacerbate the gold drain. If finance ministers know that the dollar will be devalued, they will essentially "short" the dollar until that time.

Under the Mundell-Fleming model, a nation that pegs its currency to the dollar will relinquish control of domestic monetary policy to the United States. As a

result, under the Bretton Woods system, the United States determined monetary policy for all participating nations. As the United States pursued inflationary policies, not only did other nations become skeptical of the dollar's value, but they also were forced to accept inflationary policies. This too drove countries, particularly Germany, given the German interwar experience with inflation, away from Bretton-Woods as well.

Ultimately, Nixon chooses to embrace all of the policies outlined by Connally in this meeting. Connally has secured his position as the top economic adviser in the administration despite obviously incomplete knowledge of the economics involved. Following a weekend at Camp David, Nixon unveiled the NEP on August 15, 1971, including all of the policies detailed above. The negotiations regarding the future of the international monetary system were far from over.

Chapter 4

EARLY STAGES OF NEGOTIATIONS: SEPTEMBER 1971

In the wake of the August 15, 1971 introduction of the NEP, the administration was very pleased with its decision. The suspension of convertibility in conjunction with the surcharge would result in an increase in net exports in October. The administration, namely Special Counsel to the President Charles Colson would have liked to attribute this solely to the surcharge, but McCracken urged him not to make such a tenuous assertion⁸. Most economists would agree that the decision to suspend convertibility was the right one, and Milton Friedman, a strong proponent of free-markets and an outspoken advocate of floating exchange rates allowing for independent monetary policies, told Shultz that he was “very pleased” with the decisions on the international front⁹. Those who were subject to the surcharge and end of convertibility without having a say were far less pleased with the international economic decisions.

⁸ Nixon tape conversation No. 603-7

⁹ Nixon tape conversation No. 567-8. Friedman said this in contrast with his immense distaste for the domestic decision to introduce wage and price controls. It seems unlikely that Friedman was “very pleased” with both major international decisions. More likely is the prospect that he opposed the surcharge, but this is the report that Shultz gives to Nixon.

September 4, 1971 (567 – 9) Nixon with Columbian Finance Minister Carlos Sanz de Santamaria.

On September 4, the administration gets its first direct picture of the international response to the August 15 decisions with a meeting with Carlos Sanz de Santamaria. Santamaria notes the particularly detrimental effect that the end of convertibility had on Latin American nations. Many, including Mexico and Argentina, chose to hold their required reserves in dollars rather than in gold. The end of convertibility effectively devalued the reserve holdings of these countries, resulting in considerable economic distress.

Santamaria tells Nixon that the leaders of most Latin American nations will be meeting in Buenos Aires, Argentina over the next week to prepare a unified statement to present to the United States at the upcoming IMF meeting. This declaration fuels the administration fear that other countries will form the “unified front against the dollar” detailed above. Santamaria tries to reassure Nixon, telling him that this is really an opportunity for him to gain support in Latin America.

Nixon then proceeds to display an incomplete knowledge of the economics and politics involved with the surcharge. He asserts that convertibility was ended and the surcharge was created in response to a “grave situation with the balance of payments and international monetary dislocations.” Economic theory, however, suggests that floating the exchange rate alone would have ended the international monetary crisis and established a tenable position for the balance of payments. Nixon may well have known this, as he and Connally had added the surcharge to shield the end of convertibility from domestic backlash. Nixon does assure Santamaria that the problems in the international sphere were not caused by Latin America, where countries continued to hold dollars rather than contributing to the gold drain. He

rightly asserts that convertibility could not have been ended for just some countries and notes that the regulations of the General Agreement on Tariffs and Trade (GATT) ensured that the surcharge had to be universal.

Nixon goes on to reestablish himself as a proponent of free trade, saying “I don't believe in building walls.” The surcharge is described as “temporary,” a key word for future administration negotiations. Nixon then says that the tariff was necessary because Japan and the European Economic Community were “good competitors.” When Santamaria asks what kind of statement he can bring back to the rest of Latin America, Nixon says that he wants a statement that makes clear that the decision was not made as a response to Latin America and that the surcharge is temporary.

September 9, 1971 (568 – 9) Nixon, Haldeman, and Connally.

Domestically, the decisions made on August 15, 1971 are reading much better. In the ever important press cycle, the August 15th announcement dominated two weeks of coverage. The time has come now for renegotiation to begin in earnest, and Nixon is getting mixed advice from his advisers. Volcker sees the markets for dollars being opened in Europe and feels that Nixon need not feel any pressure to renegotiate there. Volcker is probably right; allowing the market to determine the exchange rate for the dollar will be more productive than trying to artificially determine a new system of exchange rates.

Connally seems to cast his own opinion in contrast with Volcker's opinion, though he repeatedly undermines it. Connally talks at length about the need to negotiate with various countries, but then tells Nixon that he “ought to not renegotiate fixed exchange rates” on the grounds that then other countries will try to devalue

unilaterally. What, then, does Connally suggest that Nixon do? He seems not to know himself.

Connally chooses simply to play on the paranoia of the President, suggesting that the Europeans are joining forces against the United States. He states that the Belgians and the Netherlands are trying to raise the price of gold, have the European Common Market fix exchange rates, and then float the currencies of the entire bloc against the dollar. This elaborate plan seems to have little basis in economic fact, a constraint that often has little bearing on Connally. Why would the European Common Market float their rates then freeze them only to float them again? Meanwhile, he evokes Santamaria, stating that Latin America is also forming a common front. He says that Japan will “play it tight and tough” and that the United States is facing a unified opposition.

Connally shows a little better grasp of trade theory, or his paranoia serves him better in this department. He notes that Canada is seeking a retaliatory tariff against the United States, and warns that other countries may follow suit. Retaliation is the simplest argument against protectionism, but Connally does not go so far as to urge the end of the tariff. In fact, in this conversation, Nixon again stresses how important the word “temporary” is to the negotiations regarding the surcharge. Nixon: “Temporary. And how long is temporary? It could be a hell of a long time.”

Connally, perhaps sensing that he is out of his depth renegotiating an economic decision that he does not fully understand, suggests to Nixon that the international monetary situation is a national security issue. At this point, Nixon declares that he will organize the State Department, the Commerce Department, and the Treasury to provide a common front. Connally plays on the national security

concern, stating that the United States “ought to have someone keeping other countries from getting together. A person in every capital.”

Nixon and Connally want to pursue alliances to protect the United States from the common fronts being formed by other economic blocs. Nixon talks about Japan being on the same base as the United States, with a shared economic and political future. He wants to issue a statement supporting the strength of the European Monetary Union, all in an attempt to find some allies who would support the United States in its decision to abandon the old system, as proscribed by Bretton Woods, completely. Nixon and Connally also discuss forming trading blocs with Mexico, Brazil, Argentina, and Colombia to protect the United States. This is the first indication that Latin America will receive some preferential treatment in the negotiations surrounding the surcharge, and hints at the creation of a free-trade area that does not ever truly arrive.

Most telling, however, is one exchange between Nixon and Connally near the end of this conversation. Nixon states outright that his political interests are more important than the economic interests, to which Connally responds, “It’s not about money anymore.”

Chapter 5

INTERNATIONAL MONETARY POLICY AS AN ISSUE OF NATIONAL SECURITY

As noted in Chapter 4, Connally paints the negotiation of the international monetary situation after August 15 as a national security issue. This is a clear opportunity for Nixon to involve National Security Adviser Henry Kissinger in the discussions, an opportunity that Nixon seizes nearly immediately. This decision to pursue a State Department-styled negotiation of carrots and sticks does throw confusion into the mix, as Nixon's economic advisers no longer have strict access to the President's ear regarding economic matters.

September 9, 1971 (568 – 12) Nixon, Haldeman, and Kissinger.

In this conversation, the complexity of having several different departments discuss an already complex economic issue becomes obvious. Nixon suggests that Assistant to the President for International Economic Affairs Peter G. Peterson work with Connally to negotiate with the Japanese, but they cannot discuss a devaluation of more than twenty percent.

Kissinger is placed in charge of coordinating this negotiation, but since he is not an expert on economics, he chooses to talk to Volcker. Nixon is skeptical of this approach; he believes that Volcker, tired of his influence being blunted, is speaking to the press about the need for the United States to float the dollar. Nixon also believes that Volcker is leading Peterson in the negotiations, beginning the marginalization of

Peterson. It is at this point that Nixon confirms that he will have one negotiating team that will hold his ear until the Smithsonian Agreement is reached in December: Connally, Kissinger, and Shultz.

September 20, 1971 (576 – 8) Nixon and Connally.

Connally becomes a major emissary for the administration, traveling extensively to negotiate administration positions on the economic issues. On September 20, he met with Nixon to prepare for one such trip. Connally states his role in the following way: he is to maintain the administration's posture and defend Nixon's long history of supporting free trade, while at the same time defending the surcharge. The plan is to tell the IMF that the United States is prepared to lift the surcharge if other nations lift their tariffs against the US. Similarly, the dollar will be allowed to float freely if the rest of the world allows their currencies to follow suit. Overall, Connally is to paint Nixon as a proponent of free-trade, fairness, and equity.

All the while, economic interests are largely ignored. Nixon and Connally are more concerned with exacting retribution on those who they feel are not treating the United States fairly.

Nixon: "I know those bastards. They're not our political friends."

He thinks that world financial leaders will deliberately disagree with US international monetary policy. When this is the prevailing administration viewpoint, there is little reason for sound economic policy to enter in to the discussion.

While he is abroad, Connally intends to avoid talking about arguably the most important element of the negotiations. The administration is willing to talk about the surcharge, but seeks to avoid mentioning changing the price of gold. Connally says that to do so would be like opening Pandora's Box.

At this point, Nixon begins to isolate various groups of the countries with whom the United States is negotiating. He talks about dealing bilaterally with Canada and Mexico, lifting the surcharge against them, and replacing the surcharge with quotas. This displays the limits of the economic knowledge of Nixon and Connally. Certainly, both the surcharge and quotas create deadweight losses for the economy. The surcharge will limit demand for imports and raise the prices of goods and services, but at the same time it does generate revenue for the government. A quota simply limits the quantity of imports, setting up the opportunity for foreign producers to raise their prices, while at the same time producing no revenue for the government. If either Nixon or Connally had a full understanding of trade theory, they would know that while removing the tariff from Canada and Mexico will endear the United States to those countries politically, replacing the surcharge with a quota will be ultimately more detrimental to the domestic economy.

The notion of retribution is all that matters. Connally tells Nixon that the rest of the world sees the United States through the same lens. He states that the Europeans feel that the US is using the surcharge to punish the rest of the world for domestic imbalances, and that the Europeans want to see concessions from the United States. Connally says that he “responded graciously” to these accusations and said that the implementation of the surcharge was “not political,” but was the unilateral right of the United States. We know from the conversations above that this was a bold-faced lie. Connally tells Nixon that the rest of the world thinks the United States will cave and renegotiate the price of gold. At this point, the discussion becomes one of whether or not the US can win the war of attrition rather than one of economic concerns.

September 20, 1971 (577 – 3) Nixon and Burns.

Conspicuously absent from Nixon's team of primary advisers in the international monetary sphere is Federal Reserve Chairman Arthur Burns. Burns could have had clout in negotiating an agreement because he “was a respected economist with years of experience and impressive credentials.” (Abrams, 177)

In mid-September, Burns comes to Nixon to ask for a place in the negotiations. Burns begins by trying to appeal to Nixon's concepts of how the negotiations are proceeding. He says that the United States cannot return to convertibility, though he has long been a personal proponent of the gold standard. Acknowledging the national security concerns, he says that raising the price of gold will reward the bad guys – South Africa, the French, and the Soviets – all of whom hold large stocks of gold reserves. Burns affirms that the French and the US are exhibiting what he calls “tactical stubbornness,” while Europe and Japan are ganging up on the US, and the Germans “don't want to play” with the United States. Nixon again makes the issue one of national security, noting that Europe and Japan need the United States for defense. He proscribes a public face for the administration as a good neighbor while in reality exhibiting the strength to defend domestic interests. Burns is a widely respected economist, but he plays right into the administration's short-run political concerns.

Burns does eventually turn to his strength – economics – but he maintains an eye for the political.

Burns: “Friedman's theory of floating exchange rates is right in a world free of politics.”

In reality, he says interventions by central banks and governments prevent a market-determined exchange rate. Now some thirty years later, we know that Friedman was

right. Burns would rather achieve a set appreciation of foreign currencies of ten to fifteen percent, but he notes, “[the foreigners] may make that impossible for us.” Again, the primary appeal is for an “us against them” mentality.

The statement that Burns wants to make to the rest of the world is that the gold price is simply a technicality that will be discussed after the fundamentals are resolved. The fundamentals about which he speaks are presumably the United States' fiscal and current account imbalances. Burns predicts that the negotiations regarding gold and the surcharge will take some 1-3 years. He is largely right.

Having established himself as an economic expert with strong sympathies for the administration, Burns begins to rather haplessly jockey for position as Nixon's adviser. Burns offers to speak “frankly” not as a representative of the administration, using the Federal Reserve's independence, but will take Nixon's position in these off-the-record discussions, provided he has Nixon's blessing. Here, Burns blatantly places the Fed's independence in jeopardy. He wants to use that independence to acknowledge that the price of gold is strictly a political concern, something Connally cannot say. Nixon hesitates, saying that Connally is a “very sophisticated politician” and the administration's spokesman. Burns responds by saying that Connally can't get the information that Nixon needs.

Burns: “There's something else, Mister President. I'm not sure Connally's your best negotiator here. He doesn't understand foreigners. And he now has, now there's a certain opinion that the Europeans have formed of him, you see. And the opinion, I think, has two dimensions: First, he's very tough, and that's good. Second, he doesn't understand us, and that isn't good.”

Burns goes on to detail several “truths” that he knows that Connally doesn't. First, that no one, not even France will insist on a return to convertibility. Second, that Germany is willing to allow up to ten percent appreciation on the mark.

Burns wants to create a role for Connally, one where Connally acknowledges that trade and the currency are of greater concern than the price of gold (though the currency concerns are wholly intertwined with the gold concerns). Burns acknowledges that the State Department should be involved. Ultimately, he is unable to win Nixon's ear, and the economic concerns remain subservient to the political ones.

September 20, 1971 (577 – 8) Nixon and Kissinger.

Kissinger, having gained a central role in the negotiation process brings a different style of negotiation to the table, one that is more about strategy than economic interests. He suggests to Nixon that the United States give guidance to Europe, trying to split European interests and prevent European unification.

Here, Kissinger tries to give Europe a carrot: offering to end the surcharge in exchange for no immediate return to convertibility.

Nixon: “The difficulty is the surcharge, Henry, is so popular domestically, we just can't end it until we get something for it. That's the, hell, the surcharge is supported by 85% of the people. Good God, you just can't give it away.”

Nixon continues the conversation by saying that there is much more at stake than economics. He does not want the negotiations to take place for primarily economic reasons. Nixon wants other countries to acknowledge their debts to the United States if the United States does something to aid them.

September 29, 1971 (580 – 5) Nixon, Connally, Burns, and IMF Managing Director Pierre-Paul Schweitzer.

For the most part, this meeting has little of substance. Nixon shows the outward face of a “good neighbor” that he described to Burns a week earlier without giving any sort of indication of the direction of policy. He contrasts the leadership role that he envisions for the United States with the public's isolationist tendencies. Nixon calls isolationism “a tragedy for the United States and for the world.” Only a week before, he had called for the tariff to continue.

Schweitzer for his part declares that he never criticized the August 15th decisions. He declares his support for the methods that the United States is using to achieve its goals, but also stresses the need for leaders to listen to one another.

September 29, 1971 (580 – 13) Nixon, Haldeman, and Kissinger.

The tone changes substantially once Schweitzer leaves the room. Nixon admits that he does not fully grasp the details of the economic situation, calling it “increasingly complicated.” He shows outright contempt for Schweitzer.

Nixon: “I gave this Schweitzer hell. Now, he's been pissing on us, this one.”

Kissinger: “[Laughs] He's been pissing on us privately all along on the cocktail circuit.”

Kissinger adds that Schweitzer is “no friend,” and Nixon complains that Burns did not stand up for the United States' interests during the conversation with Schweitzer.

Nixon is convinced that what the rest of the world wants is not what he wants. He stresses that Burns is hung up on returning to gold at a new dollar price. Nixon is right to seek a market-determined exchange rate, this will resolve the United States' imbalances, but he is doing so for the wrong reasons. Kissinger is in accordance. Having met with David Rockefeller, grandson of John D. Rockefeller,

Kissinger “told him the old system was over.” The two agree: the United States must always act in its own self-interest.

Chapter 6

A GROWING INTERNATIONALIST STANCE IN NEGOTIATIONS – OCTOBER 1971

As negotiations continue on through October, the “us vs. them” mentality persisted, but by mid-October, the need to create some sort of substantive breakthrough in the negotiations enables a thaw. Stock markets are off somewhat, and Haldeman suggests that they blame the growing international concerns¹⁰. The surcharge remains the primary tool in the negotiating arsenal of the administration, and Nixon still feels that the United States does more for the rest of the world than the world does for the United States. Nixon vocalizes this by saying, “We do so many things for people, and then they say, 'What next?'¹¹.”

October 15, 1971 (593-10) Nixon, Connally, Kissinger, and World Bank President Robert S. McNamara.

Kissinger and Connally remain the administration point-men on the negotiations regarding the international monetary situation.

Connally: “Henry [Kissinger]’s in over his head and obviously needs help [laughter all around].”

Kissinger notes the isolationist mood of the public to which Nixon had alluded previously.

10 Nixon tape conversation No. 599-6.

11 Nixon tape conversation No. 593-6.

Kissinger: “A lot of Americans don't want to play any role [in the world economy].” He calls for a reexamination of the United States' role in the World Financial System. Connally calls into question how much the United States wants to support the World Bank, the IMF, or the Inter-American Development Bank, saying that in a globalized economy, the US will become more dependent on the rest of the world for raw materials. This is oddly prescient on Connally's part, but the forces of globalization are far beyond his control.

McNamara, on the other hand, sees US interests and World Bank interests as one-and-the-same. He continues the theme of globalization, declaring that the United States, France, and Japan cannot each act unilaterally.

McNamara: “In the long-run, none of these countries can stand alone.”

Nixon concedes somewhat agreeing to do some things unilaterally, some things multilaterally, though giving no specifics. Connally also takes this opportunity to call for global action.

Connally: “We need to get everyone working on the international monetary thing.”

October 23, 1971 (601 – 6) Nixon and Deputy Assistant to the President for National Security Affairs Alexander M. Haig, Jr.

Nixon continues to have a number of minds working on the international economic issue, but Kissinger and Connally are the only advisers with the ability to make any decisions. Three of his best economic minds, Volcker, Shultz, and Peterson are placed in a working group together.

Nixon: “Their input will be accepted, but they do not have the franchise [to make decisions].”

He continues to sing Connally's praises but not for his economic knowledge. Connally has three traits: diplomatic prestige, toughness, and the ability to put United States interests first.

October 23, 1971 (601 – 33) Nixon and Ehrlichman.

At the end of October, Connally is set to visit Japan to negotiate regarding the surcharge. While he is away, Nixon can allow for little to happen since he has given little power to the rest of his economic team.

Ehrlichman: “[Connally]'s got kind of a management problem.”

Volcker and Peterson are trying to act on the issue of the surcharge, but Nixon is actively working to undermine them, particularly Peterson, who they intend to marginalize by making him Secretary of Commerce.

Nixon: “No one should be involved in monetary affairs except the Treasury, and Peterson actually rolls around in monetary affairs.”

Peterson's title is Assistant to the President for International Economic Affairs.

Monetary affairs certainly fall under that domain.

Nixon sees the renegotiation of exchange rates as the sole domain of the Treasury and the surcharge as the domain of the State Department, but recognizes you cannot extract one from the other. Regardless, he feels that Peterson's expertise is not of use in negotiations.

Nixon: “He knows a heck of a lot about it, but he just doesn't have the prestige.”

Nixon and Ehrlichman return to the August 15 decision.

Nixon: “The dollar float was Shultz's idea...Connally put the whole thing into one bag...he was the one.”

Ehrlichman is skeptical of Connally. The political packaging is, for him, not enough.

Ehrlichman: “Connally's staff work is weaker than it ought to be for the staff that he has. You have to be sure that he's got what he says he's got...There's a certain amount of bullshit in the assertions that are made out of treasury these days.”

Nixon agrees somewhat.

Nixon: “Shultz is the key to this. He knows more than Connally or Peterson...Neither Connally nor Peterson knows a hell of a lot about it.”

While Nixon acknowledges the need to get one economist, Shultz, more involved, he further marginalizes two others. Ehrlichman informs him that Burns and Volcker had lunch, a sure guarantee that neither will be able to gain the President's trust.

October 28, 1971 (606 – 2) Quadriad meeting with Nixon, Burns, Connally, McCracken, and Shultz with Peterson and Assistant to the President Peter M. Flanigan. Later, all parties leave except Connally and Nixon, and they are joined by Kissinger.

In order to consolidate the economic team before Connally's departure for Japan, Nixon calls a meeting of the Quadriad and asks Peterson to present his findings regarding the international situation to them. Peterson urges the administration to act quickly on negotiations to make use of political capital that it has gained in the rest of the world.

At this point, details of just what an agreement might look like begin to be clarified. French President Georges Pompidou sent a messenger to Peterson, stating that the French would allow the dollar to depreciate against the franc, but would not allow the franc to appreciate relative to gold. The tariff is essentially off the bargaining table with the French, as France only sends four percent of its exports to the United States.

Meanwhile, the surcharge affects 52 percent of Mexican exports, 36 percent of Taiwanese exports, and 41 percent of Korean exports, all countries that the United States is eager to trade with. The solution that Peterson suggests is an agreement to end convertibility and to lift the surcharge for any country that will allow its currency to appreciate in terms of gold. This will, however, foster conflict with many European nations. Europe, according to Peterson, is looking for concessions on trade, but Nixon is hesitant to give them up, as that will hurt the domestic agricultural sector. The agricultural bloc is absolutely necessary for the 1972 election. Even Burns is hesitant to urge negotiations on trade prior to the election. Free trade only goes so far when there is an election on the line. France has considerable agricultural interests of their own, making them hesitant to negotiate.

Nixon: "There's not a hell of a lot we can do for the French, or to them."

More importantly, the French are concerned about the gold issue. The reason that they will not allow the franc to appreciate relative to gold is that the French people have accumulated some \$4 billion in gold. The French government had urged the people to invest in gold, telling them that the price would go up, and now, facing currency appreciation, could reduce the value the savings of farmers and shopkeepers. Reducing the savings of these particular groups was politically infeasible. The French are willing to see the price of gold stay steady in terms of francs, but this will mean some depreciation of gold in dollar terms.

Peterson is worried about political costs of such an action, but Burns believes that allowing the price of gold to move from \$35 to \$37 an ounce will have limited effect. Connally is outraged, and showing that political posturing is always his utmost concern, he endorses actions that are nothing short of economic terrorism.

Connally: “No position is necessary...We said, 'we aren't going to change the price of gold.' They said, 'Oh, you don't mean that.' We could break the gold market with \$11 billion.”

Connally suggests negotiating with everyone but the French, and simply threatening the French with demonetization.

Connally: “Tell Pompidou and his people, 'You like gold? We're going to have plenty of it for you. Because we're going to unload it.’”

Peterson shows a more level head. The French are demanding an increase in the price of gold. If the US convinces them to hold steady, then that is a concession on the part of France. Furthermore, he has told the French Minister of Economy and Finance, Giscard D'Estaing, that the franc could be allowed to appreciate some five to six percent against the dollar. Peterson takes this to mean some seven to eight percent.

Each percentage point that the dollar depreciates against gold, Peterson argues, is about an \$800 million improvement in the balance of trade. Should the administration choose to pursue devaluation, there are certainly ways to spin the good economic news into good political news.

Peterson goes on to suggest a two-tiered system for gold pricing, featuring a market rate versus an official government price. Then convertibility could be reintroduced using special drawing rights (SDRs). Converting \$10 would give the individual one dollar of gold and nine dollars of government paper in the form of SDRs. This could then segue into full demonetization. Peterson argues that if no action is taken, there will be increasing foreign policy problems with Europe, again drawing the focus away from the economic argument and back to the political one.

Shultz then proceeds to lay out specific economic goals for the negotiations. He suggests establishing new fixed exchange rates (as will be done with the Smithsonian Agreement in December), ending convertibility for two years or introducing SDRs, removing trade barriers, committing the world economy to a reduced role for gold, ending the dollar's role as the “sole vehicle currency”, and creating a new architecture for the international financial system. All of these are realistic goals with reasonable economic theory to back them up. Connally, however, downplays their importance.

Connally: “Domestically speaking, the realignment of currency is much less important...The United States must leave the impression that we're not giving ground. We're taking ground...People in this country don't understand international monetary policy, and they couldn't care less.”

Nixon is sympathetic to Connally. He concedes that all of the economists in the room worry about the long-run economic results, but the political business cycle is what matters.

Nixon: “We all know that the monetary situation is going to mean a hell of a lot more, but trade issues matter more domestically...The United States has always allowed itself to get kicked in the teeth without getting anything in return.”

After the rest of the Quadriad leaves, Connally uses his unique position to bend Nixon's ear. He suggests that Nixon send out a memorandum telling all staff to stop talking about changing the price of gold and stop talking about convertibility. He attacks Burns for wanting to return to convertibility and for talking to other central bankers. He sees Burn's willingness to negotiate as a sign of weakness, regardless of the sound economic ideas that may underpin that willingness.

Connally looks for the political advantages at all turns, and he sees an end to the crisis too early as a political disadvantage.

Connally: “It may be the worst thing in the world for us to get this thing settled. If we renegotiate now, even if we get revaluation, we get no kick from it whatsoever next year.”

October 29, 1971 (607 – 4) Nixon and Kissinger.

With Connally in Japan, Nixon urges Kissinger to work more closely with Shultz.

Nixon: “Read the Peterson memorandum, but not get Peterson's...well let him bat it around a little...he's useful...he picks up a lot of information, but you and Shultz sit down and try to come up with a way that we can try to play the political and monetary game together.”

Nixon's conversation with Connally has clearly been effective. The President is hesitant to make any sort of movement that would create a bounce too early before the 1972 election.

Nixon: “Connally says we can't do anything...It's not important to change the international monetary system...The American people don't give one shit about that.”

Kissinger, however, sees political merit in rapid action and problems in delay.

Kissinger: “The Europeans will raise Cain, and the Democrats will say that we've thrown away all our friends.”

Kissinger suggests writing a proposal for what action the administration would like to see from Europe, and he and Shultz will meet to discuss the issue.

October 29, 1971 (607 – 11) Nixon and Burns.

Arthur Burns returns to Nixon to again ask for the ability to influence administration policy. Nixon continues to marginalize Burns, telling him not to talk to Kissinger about gold. Burns has been talking to Jelle Zijlstra at the Dutch Central bank, but he has been talking to Connally before making any agreements. Burns says that it is his “political responsibility” to work with other central bankers, but Connally doesn't approve. Nixon doesn't either.

Burns: “My credibility, Mr. President, is very high if I say so myself. People know me for years. I'm straight...Connally is respected the world over, that's a fact, but if he refuses to seek Zijlstra, my God, this will be whispered in all the capitals.”

Nixon: “Why don't you keep it to yourself; let me see when [Connally] returns.”

The political infighting is getting the administration nowhere on economic concerns. Emotional issues outstrip economic concerns.

Burns: “John knows so little about these things really, and he gets so emotional. He suspects foreigners, and he doesn't know foreigners.”

Burns also points out where the economic brains truly are in the Treasury.

Burns: “Paul Volcker is responsible for this...Let me tell you how it is, Mr. President.

My mistake was not talking to Paul Volcker...He feels hurt that I didn't talk to him.

And you know why I didn't talk to him? It's because there's no use talking to him.

He's a good technician, but apart from that he knows nothing, and he has no sense.”

Burns and Volcker disagree on the fundamentals of the gold situation. Burns wants to restore convertibility while Volcker sought to end the gold standard. The lunch meeting between the two mentioned above probably had no influence on either of their ideologies. Burns, however, is one of the few administration officials who recognize just how important Volcker is to the decision making process.

October 30, 1971 (609 – 11) Nixon and Kissinger.

Nixon ends the month of October with a concrete plan for negotiations moving forward. Kissinger recognizes the risk of retaliation if the surcharge is maintained. Nixon intends to lift the surcharge with Canada, Latin America, and Japan. If Europe seems to be forming a united front against the US, Nixon intends to end the surcharge against Germany to isolate them.

Kissinger appeals to Nixon's reelection campaign to urge him to make a decision. He agrees with Connally that the average American only cares about trade, but he sees a benefit in actually resolving the international monetary confusion. Kissinger: "I think we need a new system...If you can go into the election as the man who created a new system of international finance, and at the same time trade has improved somewhat, that would be the best possible outcome."

Chapter 7

LATE STAGE NEGOTIATIONS – NOVEMBER 1971

In the month of November, Nixon begins to follow through on the negotiation plans laid in late October. Connally is in Japan, Nixon sends Robert Finch as an emissary to Latin America, and he arranges to meet himself with French President Georges Pompidou, German Chancellor Willy Brandt, and British Prime Minister Edward Heath. The negotiations are all designed to improve the image of the administration, and economic concerns remain secondary.

November 3, 1971 (612 – 4) Nixon, Kissinger, Haig, and Finch.

Negotiations are underway with Canada to end the surcharge, and Finch will be leaving shortly for Latin America to pave the way for the end of the surcharge there. Neither will be announced officially until Connally returns.

November 5, 1971 (615 – 8) Nixon and Shultz.

The House of Representatives has recently added an amendment to a bill allowing the president to declare a “Balance of Trade Emergency.” The proposal came from the Treasury, and would allow the president to impose selective or general quotas or surcharges. In theory, Nixon approves of the idea, but knows that he will be expected to use this power to aid special interests in the upcoming election year. This is a rare instance in which Nixon shies away from power.

More telling is how he tells Shultz to go about convincing Connally to remove the proposal.

Nixon: “Argue the politics. Not free trade. Connally hates free trade.”

November 10, 1971 (616 – 9) Nixon, Haig, Haldeman, and Secretary of State William P. Rogers.

Nixon stresses the importance of ending the surcharge with Latin America. Eighty-one percent of Latin American exports are subject to the surcharge, and exports total some \$464 million.

Rogers met with a Business Advisory Group which is concerned about the future of the surcharge. Though Rogers is not an economist, he recognizes the danger of uncertainty with regards to investment decisions, an important distinction. Up until this point, none of the administration officials have acknowledged the danger that continuing to stall on negotiations could have on investment. The growing uncertainty regarding gold and the surcharge could become an economic liability.

November 15, 1971 (618 – 11) Nixon, Haldeman, and Kissinger.

The need for action is weighing heavily on Nixon, but he continues to primarily weigh political concerns.

Nixon: “A lot of people are pushing on this. Basically because, like Arthur Burns, they want to go back to gold.”

Nixon meets with Kissinger because “the real problem is our foreign policy” and preps Kissinger to meet with Connally (now that Connally has returned from Japan) to discuss possible action.

Kissinger: “I have no interest in any of the solutions.”

Nixon: “So we've got you in the position to just go in and talk about the politics of it.”

Connally is still hoping that the administration can stall.

Nixon: “The average guy, not the Wall Street guy, the average guy – he wants to be sure we get a good deal...[Connally] says at this point we're not quite ready to get a good deal.”

Even after his trip abroad, Connally remains mostly concerned that Nixon needs to posture himself as a strong leader. Connally tells Nixon that he needs to fight for US interests, drawing comparisons to Abraham Lincoln and Winston Churchill. Nixon, sensing the need to act, asks Kissinger to placate Connally. Connally remains the administration's chief economic thinker, even though Connally is avoiding economics rather blatantly.

Nixon: “I want you to say that: that our policy regarding this international thing was right. We should have done this. They were screwing us. Sympathize with him on that, but then say, 'Now, how do we work it out?'. ”

Nixon and Kissinger outline their own plan for how things can be worked out.

Nixon: “Now, I don't want to go back to gold, and we can't go back to convertibility. There might be a way to give Pompidou the gold thing without giving him convertibility.”

Kissinger: “That, frankly, Mr. President is where my thought is going.”

Kissinger talked to Rowland Baring, the Earl of Cromer, the United Kingdom's ambassador to the United States, and a former Governor of the Bank of England, who is willing to present a proposal so that the United States does not have to. The proposal will include no provision for convertibility.

Kissinger has also talked to an unknown, pro-American German who says Germany could allow the mark to appreciate by eight to ten percent against gold, but will not do so in favor of Germany's long-time rivals, the French. Kissinger suggests five percent dollar devaluation and a five percent mark appreciation. Nixon, seeing a political advantage, wants to play the Germans against the British.

Kissinger's plan is to allow the Earl of Cromer to make a proposal, then lift the surcharge against Canada and use that as leverage against Europe.

November 15, 1971 (618 – 26) Nixon and Kissinger.

Kissinger leaves to meet with Connally and then returns. Connally seems to be just treading water, while Kissinger tries to push the negotiations forward.

Kissinger: "I told him, 'I couldn't care less whether they revalue by 12%, 20%, or 2%...You know I'm out of my depth. I want to put the foreign policy implications before you. Do we keep dragging this out?'"

Kissinger is unable to get any commitment from Connally, who claims that he is being cut out of discussions by other administration officials. This is patently untrue, as Connally is Nixon's top economic adviser.

Kissinger then asks Nixon whether their plan to depreciate five percent against gold should be accompanied by a floating exchange rate or SDRs. Nixon finally says the economic truth that seems to have not dawned on Connally.

Nixon: "If it's not convertible, that's floating."

Nixon, not an economist, has come around to this reality sooner than his top economic adviser.

November 16, 1971 (619 – 12) Nixon, McCracken, and Shultz.

McCracken remains concerned about the issue of uncertainty and its effects on business investment.

McCracken: “It's becoming urgent for us to move in the international monetary arena... [It's having a] significantly adverse effect on business. It's pervasive.”

He also points out an important truth of international economics. As domestic economic problems intensify, countries are less apt to give concessions to their neighbors. With both Japan and Italy concerned about recessions and the United Kingdom experiencing the same economic slack as the United States, McCracken feels that they will be less inclined to give ground on issues like renegotiating currencies or the surcharge.

McCracken: “Our negotiating position is deteriorating.”

November 18, 1971 (621 – 18) Nixon and Kissinger.

Kissinger has been meeting with Connally and Shultz. The administration's willingness to place politics ahead of policy is on full display here, with Kissinger saying he has more trouble with Shultz than Connally because Shultz has “no political sense at all.”

Kissinger: “Shultz came up with a complicated economic sort of thing... [It is] a political disaster.”

Kissinger and Nixon talk about Connally being “the President's strongest man,” which provides more evidence that Connally was lying when he said that the administration was cutting him out.

Nixon: “Connally will be the architect.”

Nixon also recognizes how little his surcharge actually affected economic outcomes in 1971. Net exports affected Gross National Product by one-tenth of one percent.

Nixon: “Out international trade is so small, I don't think it makes a difference, but other people think it does make a difference.”

November 23, 1971 (623 – 3) Nixon and Connally.

Connally and Nixon lay out the final proposal. Connally is not necessarily happy with the fact that the United States will have to make some concessions.

Connally: “We're going to be better off than we were...we're not going to get all we deserve...The realignment of currencies is not too meaningful to the average American. He doesn't understand it.”

Nixon, however, is not particularly concerned. The fact that currency devaluation will make the United States' exports relatively less expensive is something that Nixon has long understood, and his appreciation of this fact has not dimmed since it was brought to his attention in August.

Nixon: “America's products are more competitive abroad.”

The details of the proposal that the administration is ready to present call for an appreciation of the mark of five percent, an appreciation of the yen of ten percent, and a depreciation of the dollar by five percent, all relative to gold. The gold price of the franc will remain unchanged. Connally wants to hold out for a 17% differential between the dollar and the yen and wants to hold half of the surcharge in reserve until Japan agrees. Connally, however, is concerned that the benefits of such a plan will occur with a lag.

Connally: “The rewards of realignment will come in '73 and '74, not in '72.”

Connally knows enough to know that demand for imports is inelastic in the short-run. Whether or not he has properly calculated the lags associated with this demand inelasticity is unclear. It seems possible that Connally is simply trying to delay to avoid political pitfalls.

Perhaps the most telling part of this conversation is the point at which Connally makes a big distinction between gold as a “monetary issue” and the surcharge as a “trade issue.” The gold issue arose as a result of the fact that the dollar was overvalued – resulting in a significant trade issue. The issue of trade and international currencies cannot be separated. Certainly, most economists, including Volcker, would agree that the surcharge was unnecessary, and could therefore be removed without changing the price of gold, but the international monetary situation was also an issue of international trade, a truth which Connally never seems to understand.

November 24, 1971 (624 – 20) Nixon, Burns, and Connally.

Nixon lays out his plan to meet with allies of the United States first to give them the proposal. He wants to meet with individuals rather than hold a conference because it will allow the individuals to believe that they have greater input. Burns suggests avoiding the issue of convertibility altogether by passing it off as a decision for the IMF, as the IMF was initially created to oversee the terms of the Bretton Woods agreement. This would enable the administration to hold off on a decision about the price of gold until after the 1972 election. Connally had been a major proponent of stalling on the gold issue up until this point. Seeing his rival, Burns, propose a realistic way to stall, Connally is contrary.

Connally: “If we decide to change the price of gold, it should be a deliberate decision that you make.”

Burns stresses the importance of the IMF in the negotiations, a body that has been previously ignored in the discussions. Reserve assets have to be made available to the IMF to facilitate trade. Connally is nervous because this implies a continuation of convertibility and provides a useful illustration. If Malaysia owes a debt to the IMF, and Malaysia holds dollars as reserves, it cannot repay its debts in dollars because the United States is in debt to the IMF. Therefore, Malaysia would have to repay in gold or SDRs, which would have to come from the United States. Connally, though not an economist, grasps the fact that convertibility will likely be a lasting issue so long as the administration fails to make a “deliberate decision” and so long as the dollar serves as an important reserve currency. This brings to light the fact that Shultz's requirement that the dollar no longer be the sole vehicle currency was quite prescient.

Chapter 8

THE END OF NEGOTIATIONS – DECEMBER 1971

On December 17 and 18, major world leaders met in Washington for a meeting of the Group of Ten (G10). Here, the proposal laid out by the Nixon Administration during the month of November was essentially adopted. Though Nixon would hail the Smithsonian Agreement, as it would come to be called, as a major victory, international monetary concerns would continue to plague the administration until 1973, when the gold standard would be scrapped altogether.

The tapes from December generally rehash the concerns outlined throughout November. Latin America, Canada, and Japan receive preferential treatment, as the administration hopes to use that treatment as leverage against the European nations¹². Interestingly, when Nixon meets with Ivan Head, the Special Assistant to the Canadian Prime Minister, Head suggests that Canada would prefer to negotiate through the IMF. Canada, unclear as to how things will play out with the dollar would have preferred that the dollar float for at least the time being¹³.

Haldeman, without realizing it, stumbles onto the issue of currency arbitrage. The Germans are buying dollars as the price of the mark rises, and will continue to do so as long as there is an arbitrage situation. The administration had

12 Nixon tape conversation No. 627-4.

13 Nixon tape conversation No. 630-18.

expected the dollar price of the mark to fall¹⁴. Still, for the time being, the administration believes it has resolved the international monetary crisis.

¹⁴ Nixon tape conversation No. 632-2.

Chapter 9

CONCLUSIONS

Few presidential administrations are quite as interesting or as frustrating as the Nixon administration. Watergate certainly reshaped the political landscape, but the economic policies of the administration have a similar level of intrigue and perhaps a greater lasting impact.

Economic crises were not new when the Nixon administration encountered them, nor are they likely to be ended by any policy in the foreseeable future. Economists and economic policymakers can only learn from the methods used to deal with previous crises. Nixon saw the international monetary crisis as a hindrance to his plans to be reelected in 1972. As such, he dealt with the crisis in a way that would enable him the greatest chances for reelection.

The issues lie mainly with Nixon's advisory team. His chief economic adviser is Connally, who is not an economist, and because the administration chooses to see the international monetary crisis as an issue of national security, Kissinger becomes second only to Connally in terms of influence over international economic policy. Respected, talented economists, including Shultz, Burns, and Volcker, are all marginalized by the administration.

Negotiations with other countries are belated in the picture because Nixon, at Connally's urging, is too focused on appearing to be a strong leader. While most economists would agree that ending the gold standard was the right choice, it is apparent that Nixon made this choice because he had to, and because he saw

politically expedient ways to make it happen. By choosing to “shield” one wise decision with several other very foolish decisions, Nixon displayed his political savvy, and his lack of concern for long-term economic outcomes. Though not as famous as Watergate, this is a legacy well worth remembering in hopes that future policymakers do not follow suit.

Table 1 - Net exports

Date	Net exports (in billions of US dollars)
10/01/70	3.2
01/01/71	4.4
04/01/71	-0.2
07/01/71	-0.1
10/01/71	-1.7
01/01/72	-3.5

Source: St. Louis Federal Reserve Bank website at <http://research.stlouisfed.org/fred2/>

Table 2 – Government deficit

Date	Government deficit (in millions of US dollars)
07/01/69	-2842
07/01/70	-23033
07/01/71	-23373
07/01/72	-14908

Source: St. Louis Federal Reserve Bank website at <http://research.stlouisfed.org/fred2/>

Table 3 – Gold outflows

Date	Gold outflows (in billions of US dollars)
01/01/70	-0.044
04/01/70	0.014
07/01/70	0.395
10/01/70	0.422
01/01/71	0.109
04/01/71	0.456
07/01/71	0.300
10/01/71	0.001
01/01/72	0.544

Source: St. Louis Federal Reserve Bank website at <http://research.stlouisfed.org/fred2/>

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