How an antigold policy emerged in the U.S.

How did it happen that the United States, the world's single largest government holder of gold (excluding the Soviet Union) committed itself to a policy which would eliminate gold from the world monetary system? Official American policy on this question can only be explained by the persistent influence which gold-short Britain, a country notorious for its poor industrial performance, has exercised over U.S. policymakers.

To understand how the dollar's link to gold was severed, one must go back to the fall of 1960, when British Treasury officials began to lobby at international financial gatherings for the gradual phaseout of the U.S. dollar and gold as the world's primary reserve assets and their replacement by a new "stateless" international unit under the auspices of the International Monetary Fund. The proposed unit later became known as the Special Drawing Right (SDR), or "paper gold".

Although President John Kennedy's Treasury Secretary C. Douglas Dillon supported efforts to expand the IMF's credit-generating capacity—IMF funds at that point were used primarily to prop up the perpetually crisis-ridden pound sterling— he balked at measures that would undermine the dollar's role. Henry Fowler, the Goldman Sachs investment banker who succeeded Dillon as Lyndon Johnson's Treasury Secretary in 1965, had no such reservations. According to author William Wiseley, Fowler convinced Johnson that the creation of the SDR was necessary in order to finance the expanding Vietnam war, which was already deepening the U.S. balance of payments deficit. By flooding the world with new liquidity, Fowler argued, the U.S. could continue to run up deficits without being forced to pay the piper.

De Gaulle's offer to the U.S.

At his famous February 4, 1965 press conference at the Elysée ballroom, French President Charles de Gaulle initiated a campaign which was to put the antigold Anglo-American faction on the defensive for the next three years. Sounding many of the same themes which have dominated discussions during the past year on the European Monetary System, de Gaulle rejected U.S. efforts to install a European theater nuclear force known as the "Multilateral Force" (MLF). "Europe, the mother of civilization, must establish herself from the Atlantic to the Urals," he stated.

De Gaulle then announced his commitment to maintaining gold as the cornerstone of the international monetary system and offered to work closely with the U.S. and other countries in undertaking the difficult task of restoring world credit: "An end to the Gold Exchange Standard without severe shock, the restoration of the Gold Standard, as well as the complementary and transitional measures which will be indispensable and, in particular, the negotiation of international credit on this new basis—all this must be examined among countries."

Who Controls World Gold Reserves?— 1960 and 1979

	Gold reserves millions of ounces end-1960	Gold reserves millions of ounces August 1979
World total	1,149.6	1,133.0
International Monetary Fund	69.6	114.5
European Monetary System members*	273.2	403.6
Belgium	33.4	42.6
Denmark	3.1	2.0
France	46.9	102.0
Ireland	0.5	0.5
Italy	63.0	83.1
Netherlands	41.5	54.8
West Germany	84.9	118.6
United States	508.7	266.7
United Kingdom	80.0	22.9
Switzerland	62.4	83.3
Japan	7.1	24.0

* Includes both gold held by individual countries and gold deposited with European Monetary Cooperation Fund (FECOM). Although Britain has belatedly added 20 percent of its gold reserves to the FECOM pool, the U.K. is not a member of the EMS and its reserves are not included in this total.

Source: IMF International Financial Statistics.

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To show the Johnson administration he meant business, de Gaulle instructed the Bank of France to make periodic calls on the U.S. Treasury's gold window, and even demanded that France's gold be physically shipped to Paris rather than stored in the Federal Reserve's New York bank vaults. De Gaulle's Finance Minister Michel Debrè, meanwhile broke up every international meeting called to discuss Fowler's plan to create the SDR by insisting that only a gold-based monetary system was acceptable to France.

Although the U.S. media characterized de Gaulle's campaign as "anti-American" and "antidollar," the truth was that de Gaulle offered the U.S. an opportunity to reverse the falloff in fixed-capital replacement and investment which had already begun. In tandem with his offer of Paris as a negotiating site for speeding up an end to the Vietnam war, de Gaulle also offered a "way-out" on the monetary front. A one-time revaluation of gold against the dollar, as de Gaulle proposed, would have strengthened the dollar, since the U.S. still had enormous gold reserves. This would scarcely have solved all the U.S.'s economic problems but it might have provided a breathing space within which the administration might have taken steps to revive the U.S. productive base, possibly acting on de Gaulle's earlier suggestion of East-West collaboration to industrialize the postcolonial sector. Johnson and, later, Nixon were to take a very different road, however.

The 1968 Gold Pool collapse

On November 25, 1967, the severest sterling crisis of the postwar period culminated in a hefty devaluation of the British currency. Hardly had the antisterling speculation subsided when Fowler's public remark that the dollar was now "in the front line" provoked a wave of dollar dumping and a bidding-up of gold. Fowler's statement was only one example of how "bumbling" U.S. officials managed to parlay a little investor nervousness into a full-blown dollar panic. The panic resulted in the March 1968 dismantling of the London Gold Pool—an initial step toward eliminating dollar convertibility into gold.

That there was a method in American officials' madness is demonstrated by the fact that, as early as October 1967, the New York Council on Foreign Relations' *Foreign Affairs* magazine featured an article which outlined in advance the scenario under which the U.S. was to abandon gold. The article in question, "Gold and the Dollar," was written by Chase Manhattan economists William F. Butler and John V. Deaver. It instructed the U.S. government to play a game of "international chicken" with its European allies. If France continued to insist on a gold revaluation, then the U.S. should threaten to "go crazy" and terminate dollar-gold convertibility.

> But to make a credible case, official U.S. statements must clearly indicate that we will never support a price higher than $35 an ounce *even if other central banks should use their dollars to buy all the gold in the U.S.Treasury.* And, to make this credible, it is necessary to register a preference for the consequences of such a policy over the consequences of a gold-price rise. This does not involve threatening our European neighbors. It does involve spelling out our response to a threat to the international monetary framework in the form of an assault on our gold stocks. If that response were to be a suspension of the privilege now granted by the U.S. Treasury to buy and sell gold, with future sales and purchases of gold made only at the discretion of the Treasury and at the fixed price of $35 an ounce, then the end of the trail would be bleak indeed for all nations, but especially for those with large international reserves, including gold.

Although Assistant Treasury Secretary Robert Roosa accused France of "mischiefmaking" in a Dec. 4, 1967 *Newsweek* interview, the gold crisis was not of French origin. Beginning in November, the French government had suspended its policy of converting its surplus dollar holdings into gold. True, *Le Monde* columnist Paul Fabra had just leaked word that France had withdrawn from the Gold Pool as of June 1967, but Fabra admitted that he often drew on sources other than the French government. France had quietly pulled out of the London Gold Pool, an arrangement in which the 8ank of England conducted intervention in the gold market on behalf of the other central banks, because the Bank of France was losing gold reserves in an effort to maintain what it deemed an indefensibly low official gold price.

Meanwhile, London and New York turned the gold rush to their own advantage. In early March 1968, Senator Jacob Javits (R-N.Y.) called on the U.S. govern-

ment to stop selling gold for dollars. Then, on March 17, with world markets in an uproar, an emergency central bankers' meeting was called where U.S. officials rammed through an agreement to establish a "two-tier" gold market. The central banks would no longer attempt to regulate private gold trading and, while the official gold price would be maintained, central bank purchases were to be discouraged. France alone abstained from this agreement.

Another coup took place at the March 29-30 Stockholm meeting of the Group of Ten finance ministry officials, where every industrialized country, excepting France, agreed on the creation of the SDR. In an April 2 memo to the Federal Reserve Open Market Committee (FOMC), Robert Solomon, a high-ranking Federal official who helped frame the Washington gold agreement, exulted "That pronouncement, together with the Stockholm agreement on Special Drawing Rights, can be interpreted as constituting a demonetization of gold at the margin." (Solomon is now a senior economist with the Brookings Institution.) The May 1968 student uprising then paralyzed the French economy and so weakened de Gaulle that, from then on, the French government would merely argue the terms on which SDRs would be created.

August 1971

On Aug. 15, 1971, President Nixon stunned the world with his announcement that the U.S. would float the dollar and terminate the U.S. currency's convertibility into gold. Although the experience of wage-price controls (another feature of the August package,) has etched this event into the consciousness of Americans, few people are aware of the developments immediately preceding Nixon's decision.

First, on Aug. 6, Henry Reuss, a Wisconsin Democrat who now heads the House Banking Committee, issued a subcommittee report recommending that the U.S. abandon the dollar's linkage to gold. Reuss's report helped spur market speculators. The coup de grace, however, was delivered by the Bank of England, which demanded on Aug. 13, that the Fed immediately convert $3 billion in dollar holdings into gold!

According to a January 1972 *Fortune* article, "How the U.S. Got on the Road to a Controlled Economy," Federal Reserve Chairman Paul Volcker, then Undersecretary for Monetary Affairs in the Treasury department, was the real mastermind behind the Aug. 15 package—not Treasury Secretary John Connally. *Fortune* reports that from July 10 on "a small Treasury group under Volcker worked steadily on the ingredients of the monetary package that was ultimately announced." Even Connally's "get-tough" international trade policy was based on a special briefing which Volcker, a former Chase Manhattan official, prepared for him in February when Connally came into office. Connally's "bully boy" image may have been his own idea, but he was following, in the main, a Volcker script.

In his *Before the Fall*, William Safire provides a transcript of the White House staff meeting at Camp David on Aug. 15 where Nixon made the fatal decision to abandon gold. Connally, in a fit of hysteria, insists that Britain's demand for gold necessitates closure of the gold window because "anybody can topple us." Volcker, meanwhile, calmly explains how gold demonetization can be used as a club to force European and Japanese revaluations. Federal Reserve Chairman Arthur Burns cautions about the effects of a U.S. gold break on American relations with continental Europe, but in the end, the Volcker-Connally economic warfare strategy holds sway:

> **Connally:** What's our immediate problem? We are meeting here because we are in trouble overseas. The British came in today to ask us to cover $3 billion, all their dollar reserves. Anybody can topple us—anytime they want—we have left ourselves completely exposed. There is no political risk—Reuss wants you to do it. . . .
>
> **Burns:** Yes, this is widely expected. But all the other countries know we have never acted against them. The good will—
>
> **Connally:** We'll go broke getting their good will.
>
> **Volcker:** I hate to do this, to close the window. All my life I have defended exchange rates, but I think it is needed.
>
> **Connally:** So the other countries don't like it. So what?
>
> **Volcker:** But don't let's close the window and sit—let's get other governments to negotiate new rates.

—Alice Roth

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