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Britain, Nixon and the End of Bretton Woods

In August 1971, Richard Nixon decided to 'to suspend temporarily the convertibility of the dollar into gold or other reserve assets'.[1] The international monetary system, which had intermittently relied on gold since 1821, would cut all ties with the yellow metal. Two main factors were at play in the final years of the Bretton Woods system. Inflation in the United States was increasing. This undermined the credibility of the dollar. Also, there was a decrease in international monetary cooperation. The shift to the Nixon administration, according to Coombs, meant that international financial policy 'became increasingly dominated by political considerations, much like French policy under de Gaulle'.[2] Nixon was the American equivalent of de Gaulle in trying to derail the international monetary system. Until that point many international monetary decisions were made after discussions in Basel. Nixon's in 1968 returned power to Washington.

This marked the end of the pound's influence within the international monetary system. Until then, despite its diminished importance, the pound still played a surprisingly significant role. The progressive dissolution of the Bretton Woods system with its two key reserve currencies (the dollar and sterling) meant the end of the pound's international role. The system would now be based on the dollar alone. The end of the fixed exchange rate system and market liberalisations during the 1970s and 1980s would remove the pound's significance as an international force. Further, the stability of the international monetary system would no longer rely on decisions made in Westminster.

[1] Richard Nixon, *Richard Nixon: Speeches, Writings, Documents*, ed. Rick Perlstein (Princeton, NJ: Princeton University Press, 2008), 219.
[2] Coombs, *The Arena of International Finance*.

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Cooperation suffered from the run on gold that followed the 1967 devaluation. Unlike the interwar years, sterling devaluation did not lead to competitive devaluations. But just as the 1931 devaluation marked the beginning of the end for the gold standard, 1967 marked the beginning of the end for the Bretton Woods system. International monetary cooperation would suffer. The *New York Times* had summarised this shift a week after the 1967 devaluation. The paper read: 'The gold rush that has developed since sterling's devaluation represents a dangerous new challenge to the dollar and the existing monetary system that is based on cooperation between the United States and other industrial powers.'[3] The devaluation had unleashed the temptation for more nationalistic behaviour. These forces would lead to the end of the Bretton Woods monetary system. The system had always been based on cooperation.

An interwar-like beggar-thy-neighbour devaluation spree was only narrowly avoided. Just a few days before Britain devalued, France refused to commit *not* to devalue in response to sterling. The *New York Times* revealed that 'France took this ambiguous stand at the fateful moment 10 days ago [15 November] when experts of the Group of Ten discussed the possibility of the British pound' being devalued.[4] A sterling devaluation followed by a French devaluation might have triggered devaluations around the world. This could have created a currency war similar to that in the interwar years. And that was exactly what the Bretton Woods institutions were built to avoid.

THE NIXON SHIFT

Nixon's election altered the landscape of international monetary cooperation. European monetary relations with the United States now became political. Technical cooperation was replaced by political blame. Central bankers and institutions set up in Basel continued to function. But Nixon shifted control over US monetary policy from the New York Fed to Washington and the US Treasury. Cooperation shifted from secret loans among friends to public speeches blaming Europe. Coombs noted the change: 'As the Nixon administration took office in January 1969, the Federal Reserve Bank of New York was abruptly cut off from

3 'The Defense of the Dollar', *New York Times*, 26 November 1967, E12.
4 'France Refused Pledge on Franc: Sources Confirm Her Stand on Eve of the Pound Cut. Paris Didn't Pledge Firm Franc on Eve of London's Devaluation', *New York Times*, 25 November 1967, 57.

Washington discussions of foreign financial policy.'[5] This was contentious, as decisions on cooperation were made at the central bank level, with limited government involvement. The Fed's discretionary power in Basel was now limited.

The incoming Nixon administration had a negative impact on international monetary cooperation. Using archival materials from the New York Fed, I document in detail how the new administration contributed to the breakdown in cooperation. If the Bank of England took roughly from 1945 to 1964 to warm up to the idea of cooperation with the Fed, 1969 marked a breakdown in cooperation – this time coming from the US side. Full and open cooperation between the Fed and the Bank of England lasted from 1964, when the Bank was finally ready to cooperate, to 1969. Then the Fed was slowly cut out of international monetary questions in favour of the Treasury under Nixon's tight control. The literature has shown that the Bretton Woods period was a time of monetary cooperation.[6] But cooperation took time to build up. And quickly collapsed.

The New York Fed recognised this shift in its 1971 annual report. The Fed described how Nixon closing the gold window (known as the Nixon shock) changed everything. The report reads: '[T]he operation of the International Monetary Fund (IMF) was almost completely immobilized, and the entire fabric of international monetary cooperation was badly strained.'[7] From that point on, routine operations were complicated. The new currency regime led to mistrust on both sides of the Atlantic. The tone of the dialogue between central banks changed.

A first example of this can be found in 1969. The Fed had just heard that the Bank of England had repaid $75 million to Germany 'at the insistence of the Germans'.[8] This was a problem for the Federal Reserve. It wanted to be the most senior creditor and be repaid first. In response, the president of the Fed, Alfred Hayes, called Karl Blessing, the Bundesbank president, to 'urge that the Germans allow the Federal Reserve priority in British debt repayments'.[9] Something similar occurred in 1970. The US Treasury and the Fed again were worried about being repaid after other central banks.

[5] Coombs, *The Arena of International Finance*, 204.

[6] This narrative is present throughout the literature. But maybe the most emblematic account is Toniolo and Clement, *Central Bank Cooperation*, 2005.

[7] Federal Reserve Bank of New York, annual report 1971, 3 March 1972, 32–3.

[8] British repayment of debt to Germany, David E. Bodner to files, 23 October 1969, New York, Archives of the Federal Reserve, box 107320.

[9] Ibid.

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When asked to repay the Fed first, Hallet of the Bank of England replied that 'evidently there had been some misunderstanding between him and Coombs' on the schedule.[10] This meant that 'the Bank of England would not be able, without great embarrassment, to change the scheduled repayments'.[11] In response, Crowley of the Fed consulted the Treasury about extending the Bank's swap line with the Fed. He was told to 'hold up renewal of the facility, pending a determination as to priorities and schedules for repayment of debt'.[12] The Treasury was adding conditionality to swap lending. In Chapter 8, we saw how swaps were approved informally by telephone. They were available to the Bank within twenty-four hours or less. This changed with the new administration.

Another example comes from 1971 when the Bank needed to extend another credit agreement. Governor O'Brien called the Fed to express his concerns, because 'he had heard some comment from this country [the United States] to the effect that we hope to reduce American commitment and persuade the French to join in the credit'.[13] The rumours were that the Bank would have to ask France for credit. This was not only annoying but also quite humiliating for the Bank of England. O'Brien stressed that 'the French could be troublesome' and that 'he would consider it most unfortunate if the discussion of the [credit] renewal were to become anything more than a rather routine exercise'.[14] The Bank's views were communicated to Paul Volcker, Under Secretary for International Monetary Affairs at the Treasury. This episode, although benign in nature, illustrates the new atmosphere. Previously, such matters were routine. They could be resolved quickly and informally. Now, however, even if the Fed had 'general sympathy with the views expressed' by O'Brien, they could not do more than forward the information to Washington. The centre of power had shifted from New York and the Fed to Washington and the Treasury.

THE NIXON SHOCK

The Nixon shock was the result of Nixon wanting to make a mark. He was unconcerned about the impact of US policies on the international

[10] Telephone conversation with Messrs Robeson and Hallett of the Bank of England, Robert J. Crowley to files, 18 March 1970, New York, Archives of the Federal Reserve, box 107320, p. 1.

[11] Ibid. [12] Ibid., 2.

[13] Conversation with Governor O'Brien, memorandum sent to Alfred Hayes, 4 March 1971, New York, Archives of the Federal Reserve, box 107320.

[14] Ibid.

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monetary system. The decision to close the gold window was made at Camp David (US presidents' country home in Maryland). It all happened over the weekend of 13–15 August. Nixon told the participants that there should be 'no telephone calls out of Camp David'.[15] Volcker had warned the president that 'it was too risky to wait before removing the threat of a run on America's remaining gold reserves, that a tidal wave of gold redemptions could come as early as Monday'.[16] The decision had to come before any run on the dollar.

The week before Nixon announced the closing of the gold window, the Bank of England managed to buy more dollars than usual. It accumulated $598.5 million on the market, a significant amount.[17] Before Nixon's declaration, the London market was under stress, with heavy dollar selling. The Bank was on the other side of these sales. It was an opportunity to replenish its dollar reserves. Meanwhile, the United States was planning its unofficial exit from the Bretton Woods system. Nixon later wrote:

> The strongest opposition came from Arthur Burns, Chairman of the Federal Reserve Board. He wanted us to wait. Even if all the arguments were right, he said, he still felt that there was no rush. He warned that I would take the blame if the dollar were [sic] devalued. '*Pravda* would write that this was a sign of the collapse of capitalism,' he said. On the economic side he worried that the negative results would be unpredictable: the stock market could go down; the risk to world trade would be greater if the trade basis changed; and there might be retaliation by other countries.[18]

Burns' opposition did little to stop Nixon. Connally said the 'country was completely exposed to the world, and when Burns referred to the "goodwill" of allies, Connally interrupted: "We'll go broke getting their goodwill"'.[19] In the end, the debate concluded with a decision in favour of closing the gold window.

On Sunday night, Nixon addressed the nation. He announced a series of measures to stimulate the economy. Along with the closing of the gold window, he introduced a temporary 10 per cent surcharge on all dutiable imports. The belief was that other countries would feel compelled to revalue their currencies, as Irwin argued.[20] Finally, to curb inflation he announced ninety days of price and wage controls. The Nixon shock was

15 Conrad Black, *Richard M. Nixon: A Life in Full* (New York: Public Affairs, 2007), 741.
16 Ibid., 741. 17 Dealers' reports, 1971, London, Archive of the Bank of England, C8.
18 Richard Nixon, *RN: The Memoirs of Richard Nixon* (New York: Simon & Schuster, 2013).
19 Black, *Richard M. Nixon*, 741.
20 Douglas A. Irwin, 'The Nixon Shock after Forty Years: The Import Surcharge Revisited', *World Trade Review* 12, 1 (January 2013), 29.

the most important part of the announcement and had the most durable effects. As Thomas Zeiler puts it: '[B]etween 1929 and 2008 there occurred another crisis that signalled a profound shift in the country and the world, and in the psyches of ordinary people. It began on August 15, 1971. On that date, Richard Nixon took the first steps towards ending the gold standard.'[21]

Ironically, Nixon used the frequency of financial crises as an argument to close the gold window: 'In the past 7 years, there has been an average of one international monetary crisis every year. Now, who gains from these crises? Not the working man; not the investor; not the real producers of wealth. The gainers are the international money speculators. Because they thrive on crises, they help to create them.'[22] With hindsight, this is interesting as the literature shows that the Bretton Woods period was a time with the fewest financial crises of any type.[23] Certainly, closing the gold window did not help reduce the number of crises. Facts aside, it remains that Nixon had excellent skill to explain complex questions to the public.

Kissinger later admitted that Nixon knew that his decision would be long-lasting and could guarantee his legacy: '[H]e saw himself as revolutionizing international economics as he had already transformed international diplomacy. He reveled in the publicity coup he had achieved. As he often did he asked me innumerable times to recite foreign reactions, which were mixed at best; he was delighted by the domestic approval.'[24]

According to Nixon, closing the gold window 'turned out to be the best thing that came out of the whole economic program'.[25] The way Kissinger describes it is telling:

> This was to have many, largely unforeseen, consequences as the years went on. The immediate significance of the new program was its effect abroad; it was seen by many as a declaration of economic war on the other industrial democracies, and a retreat by the United States from its previous commitment to an open international economic system.[26]

Nixon's focus was domestic. He cared little for the rest of the world. According to Ronald McKinnon, the 'dollar devaluation violated the

[21] Thomas W. Zeiler, 'Requiem for the Common Man: Class, the Nixon Economic Shock, and the Perils of Globalization', *Diplomatic History* 37, 1 (1 January 2013), 2.

[22] Nixon, *Richard Nixon*, 217.

[23] Michael Bordo et al., 'Is the Crisis Problem Growing More Severe?', *Economic Policy* 16, 32 (April 2001), 51.

[24] Henry Kissinger, *White House Years*, reprint ed. (New York: Simon & Schuster, 2011), 1126.

[25] Nixon, *RN*.

[26] Kissinger, *White House Years*, 1126.

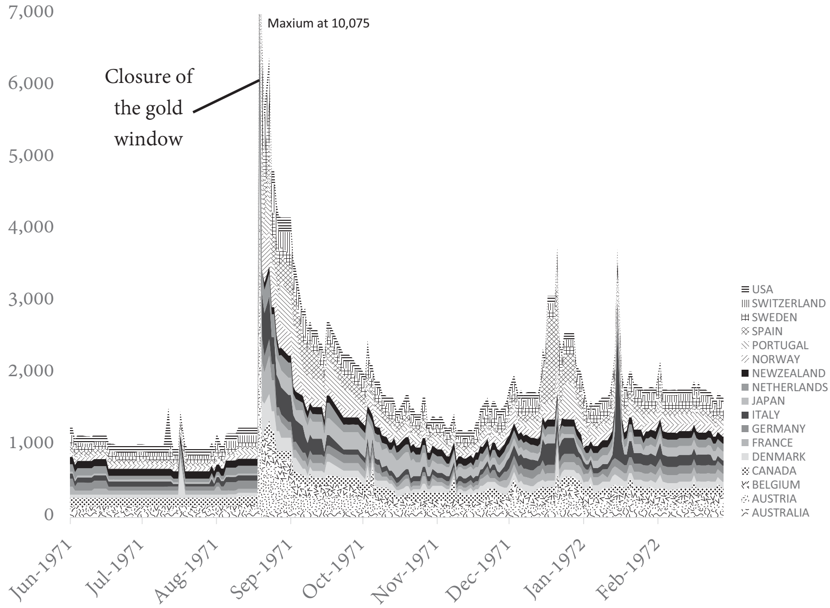

Figure 12.1. Bid–ask spread index for eighteen countries
Source: Bid–ask data: Accominotti et al., 'Currency Regimes and the Carry Trade'; computation: the author.
Note: The data are indexed to avoid any single currency spread biasing the graph and showing the shock in a comparable way for all currency pairs. All spreads are indexed on the average of the whole of 1971–72 = 100.

unwritten rule (understandings) by which the fixed-rate dollar standard had successfully operated for the previous twenty years'.[27]

How much of a surprise was the decision to close the gold window? And how much had markets already factored in this 'shock' in prices? The London market gives an indication of the magnitude of the shock. Here again I rely on the bid–ask spreads. They are presented as an index (average for 1971–72 = 100). This allows a comparison of the magnitude of the shock on each currency individually in a single chart.

News of the gold window's closure came as a shock to market-makers in London. The spreads on foreign exchange quotes increased ten-fold after the announcement. Figure 12.1 illustrates this extraordinary shock. Even

[27] Ronald I. McKinnon, 'Bretton Woods, the Marshall Plan, and the Postwar Dollar Standard', in *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform*, ed. Michael D. Bordo and Barry Eichengreen (Chicago, IL: University of Chicago Press, 1993), 604.

for the whole of September, dealers were still offering five times higher spreads on average across the seventeen currencies in Figure 12.1. Dealers were most likely protecting themselves against uncertainty in the market following the initial shock.

STABILISATION AT LAST

The end of Bretton Woods was a time of crisis and reinvention for the international monetary system. For sterling, things finally seemed to improve, for a while at least. It was a period of respite for sterling. There was less pressure on the foreign exchange market. Reserves seemed to be increasing somewhat. The Bank's dealers were less busy defending the pound and the currency exhibited less volatility. The Nixon shock brought an end to this quieter period. Even if sterling benefited from the Nixon shock, its positive effects on the dollar would be only temporary. The 1970s would again be a difficult time for sterling.

After being close to the lower band for most of the Bretton Woods period, the pound finally appreciated against the dollar from the late 1970 onwards. As Figure 12.2 illustrates, the three-month forward rate improved against the dollar following the Nixon shock. The sterling forward rate even broke the Bretton Woods upper band of $2.42 per sterling after July 1971.

Similar trends can be seen in ten-day volatility. Figure 12.3 highlights that the three-month forward market, the most volatile official sterling market, was stable from the end of 1969 to the summer of 1971. After the Nixon shock, the market again became volatile.

In terms of intervention, dealers were less busy defending the pound and only reported nine dollar sales in 1971. In that year, only 3 per cent of the trading days were spent defending sterling. In 1967 as a comparison, dealers spent short of 30 per cent of the trading days defending sterling. In 1970, their job was even easier as market conditions allowed them to buy dollars and not worry about sterling on 91 per cent of trading days.

The reserve position improved in 1970, as the figures from the EEA show in Figure 12.4. But the United Kingdom's reserve position was still not good. Gold reserves were diminishing starting in 1970. Dollars on the EEA account mainly came from foreign credits and the gold reserves were low. On average during the Bretton Woods period, EEA gold reserves stood at £458 million.[28] At around £200 million during 1969–70, they were substantially below this average and the situation was far from ideal.

[28] This is calculated from 31 March 1947 to 10 February 1971 based on all the available daily data.

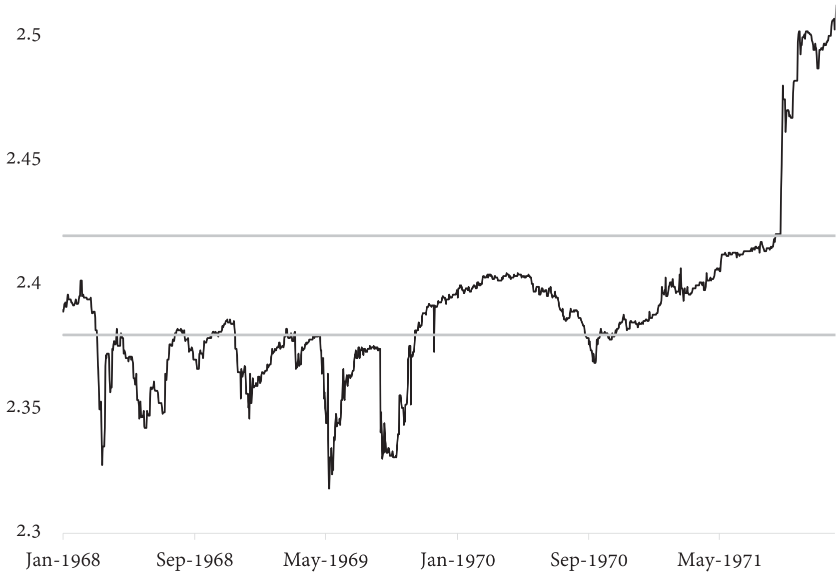

Figure 12.2. Three-month sterling–dollar forward exchange rate
Source: Accominotti et al., 'Currency Regimes and the Carry Trade'.

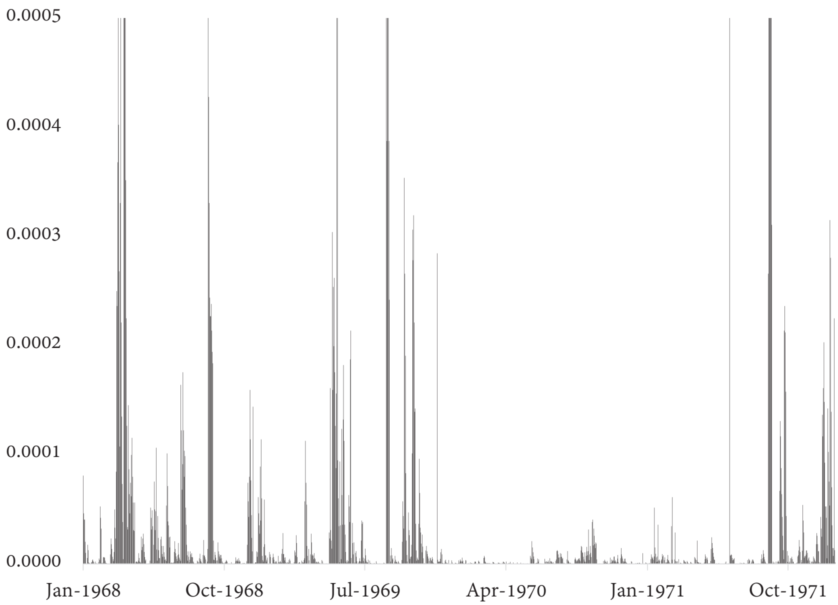

Figure 12.3. Three-month sterling–dollar forward exchange rate, ten-day local volatility
Source: Accominotti et al., 'Currency Regimes and the Carry Trade'. Note: The scale is cut at 0.0005 for better readability.

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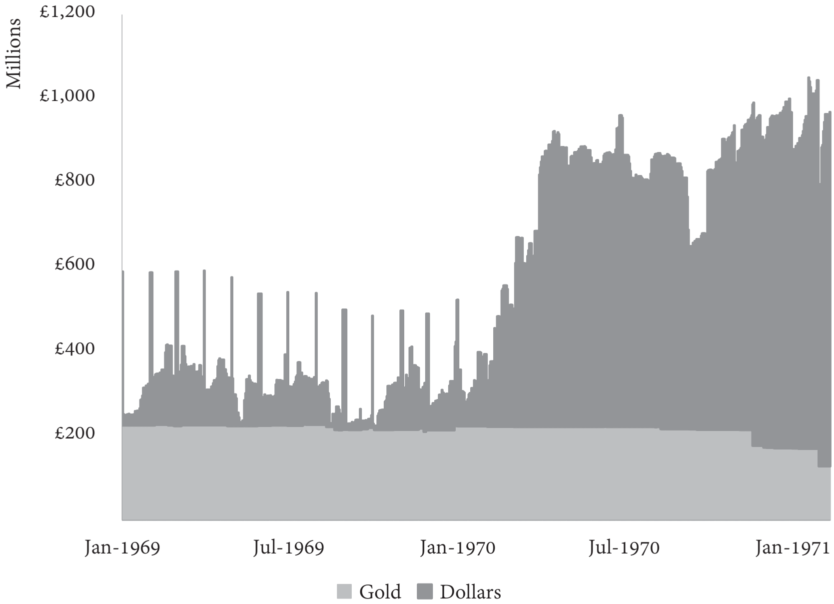

Figure 12.4. EEA dollar and gold reserves
Source: EEA ledgers.

Another trend is that the Bank no longer used swaps to hide reserve losses after 1969. The periodic spikes that appeared in 1968 ceased in 1970. There are still increases around the month-end at some points, but they are not as marked and last longer than at the height of window dressing.

This calmer period would not last. New crises would arise, requiring more loans from the international community. Additionally, the international monetary system would go through several new frameworks, such as the Smithsonian agreement of December 1971, followed by the snake in the tunnel in April 1972 before Britain officially floated its currency on 23 June 1972. As Kissinger put it, 'The Bretton Woods agreement, which had regulated international monetary arrangements since 1944, was being made irrelevant' by Nixon's speech.[29] This marked the end of over a century and a half of gold-based systems and the beginning of a new era in the international monetary system.

[29] Kissinger, *White House Years*, 1126.

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