FEATURE REVIEW

Richard Nixon and the Failed War Against the Trading World


Foreign economic policy is rarely the stuff of high drama. The great exception was the administration of Richard Nixon. For a quarter century after World War II the United States, as alliance leader, had subordinated economic to political interests as it rehabilitated Western Europe and Japan to help contain the Soviet Union. But during Nixon’s first term, economics threatened to trump politics. With Allied economies fully recovered and U.S. hegemony on the wane, issues of trade and money emerged to roil the Western alliance. By 1971, the United States saw itself less as the leader of the system than as its victim. That year, Nixon launched economic hostilities against the rest of the trading world by dismantling the postwar international monetary system and trying to force open foreign markets for American exports. These events are among those covered in a recent addition to the State Department’s Foreign Relations of the United States series, *Foreign Economic Policy, 1969–1972; International Monetary Policy, 1969–1972.* The title is the first indication that this volume will not measure up to the department’s usually high standards: international monetary policy is an integral part of foreign economic policy, and the choice to treat it separately impairs narrative coherence.

Nixon did not create the international economic problems that he faced on entering office in 1969. He inherited them. There was, first of all, the increasingly dysfunctional Bretton Woods monetary system. Created in 1944, that system was designed to facilitate an open and stable trade world by pledging participating nations to exchange the currencies of other nations for their own at fixed exchange rates. But in the immediate postwar years, the system faced a problem. Nations need monetary reserves to conduct international transactions, gold traditionally serving that purpose. But European central banks had exhausted their gold during the war. That meant that the U.S. dollar, which was convertible into gold and therefore as good as gold, became the reserve currency for most of the world. During the 1950s, the United States obligingly replenished the reserves of the others by running balance-of-payments deficits:
that is, it paid out more dollars for imports, foreign investment, military and economic aid, and travel than it earned from exports and return on foreign investment. During the early 1960s, the trickle of dollars abroad turned into a hemorrhage, and the dollar shortage became a dollar glut. In possession of dollars worth more than all the gold in Fort Knox, foreign central banks chose to hoard dollars rather than redeem them, for fear of wrecking the system. The dollar had become de facto inconvertible, the world had moved—unplanned—to a dollar standard, and foreign governments found themselves forced to absorb unwanted dollars, which threatened their ability to control their own economies. The Kennedy and Johnson administrations worried about the payments deficit and attempted to stanch the dollar flow. None of their expedients worked. As this volume reveals, various agencies of the government during the Nixon administration continued to debate ways to cut the deficit, including reducing overseas personnel, pressuring West Germany and Japan to offset some of the cost of their own defense, and even depreciating the dollar. Depreciation would reduce the payments deficit by making imports more expensive and exports cheaper.

America’s declining trade balance was, in fact, one of the main reasons for its growing payments deficit. In the mid-1960s, the United States was running a large trade surplus of U.S.$6–8 billion a year, helping to keep its payments deficit within bounds. But the surplus dwindled toward zero as the decade ended, and the American payments deficit worsened. The new administration acknowledged that inflation was helping to price American goods out of world markets, but it also blamed the discriminatory trade practices of other governments. Instinctively a nationalist, Nixon proved less willing than his predecessors to subordinate American economic interests to allied harmony. According to the minutes of a meeting in March 1969, “The President linked NATO to soybeans. He said that his support for NATO would be seriously jeopardized if the Europeans took restrictive action against U.S. exports. . . . The President also said that the EEC [the European Economic Community] ‘could forget U.S. political support’ if it turned inward economically” (p. 49). Allied diplomats were soon embroiled in disputes over “citrus, tobacco, poultry, and lard” (p. 134). Meanwhile, the administration developed an approach to Japan that implicitly made the return of Okinawa contingent on Japanese trade concessions. In particular, Nixon wanted Japan to limit textile exports to the United States so that he could redeem a campaign promise to South Carolina Senator Strom Thurmond.

Despite acrimonious economic diplomacy, the Nixon administration was initially not all that concerned about its foreign economic problems. At least, Undersecretary of the Treasury Paul Volcker was not concerned, and he was the man who counted. Volcker chaired an interagency committee on international monetary affairs that presented its report to the president late in June 1969. Though the so-called Volcker Report is indispensable for understanding policy during the first Nixon years, the editors of this new volume of FRUS
include only its policy options. In the analytical sections of the report, Volcker conceded that the American payments deficit imposed a real cost on surplus countries because the deficit was a mechanism for exporting U.S. inflation. But the system also conferred real benefits on the United States. Other nations running payments deficits had to impose painful austerity measures at home to restore equilibrium. But because the dollar was a reserve currency, the United States could print up as many dollars as it wanted in order to sop up imports, acquire foreign businesses, and pay for foreign adventures such as Vietnam, leaving its partners no choice but to absorb dollars they did not want. As one French critic of American dollar domination wrote with no little bitterness, the American payments deficit was “a deficit without tears.” 1 The Volcker report gave lip service to reforming the Bretton Woods system by adding an element of flexibility to the exchange rate, a policy Volcker personally opposed. Volcker’s real intent was to preserve intact the existing system, along with its advantages, as long as possible. If efforts to reduce domestic inflation worked, perhaps the system could be preserved indefinitely. In short, Volcker wanted to deal with the deficit by doing as little as possible. This policy, known as “benign neglect,” implicitly pitted America’s monetary interests against the interests of its allies and infuriated them.

The administration’s effort to restrain inflation brought on a recession late in 1969, prompting a switch to expansive fiscal and monetary policies in 1970. As money grew easy, interest rates plunged, prompting short-term capital from the U.S. to seek higher interest rates abroad. This cascade of dollars drove down the dollar’s price in world currency markets. Obliged to support fixed exchange rates, foreign central banks had to intervene by buying dollars. Printing up their currencies for this purpose meant inflating their economies. Paul McCracken, chair of the Council of Economic Advisers, drew the logical conclusion: “A system that combines rigidly fixed exchange rates with free trade and capital movements appears to be unworkable” (p. 438).

In early 1971, Nixon recruited two new officials who fundamentally reoriented administration foreign economic policy. One was former Texas governor John Connally, who became secretary of the treasury. The other was Peter Peterson, former president of Bell and Howell, and Nixon’s adviser on the international economy. In 1969, Volcker had defended the status quo in large measure because the overvalued dollar kept imports cheap. In 1971, Connally and Peterson radically shifted focus. To them, the point of policy had to be to expand exports, which they equated into jobs. The crucial document for understanding the neomercantilist mood descending on the White House in 1971 is a report on the international economy submitted by Peterson to an enthralled Nixon in April 1971. “I believe we must ask—are we advocating our own economic interests as forcefully as we should?” Peterson wrote. “We need to make

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it clear that we aim to increase the export of goods and not jobs and that the export of goods abroad means the creation of jobs at home.”

Every additional $1 billion in exports would create 60,000–80,000 new jobs, Peterson contended. Connally, meanwhile, got Nixon’s full attention by stressing that an export crusade would appeal to organized labor, a constituency that Nixon was keen to recruit for his New Majority. The editors of the volume of FRUS under review print excerpts neither from Peterson’s paper nor from the scathing rebuttals of its mercantilist premises by the administration’s professional economists.

The key man was Connally, who had no credentials for the Treasury except Nixon’s faith that the former Texas governor could rescue him from the economic problems that threatened his reelection in 1972. In the spring of 1971 Connally was considering a series of dramatic measures that would repudiate past administration policy and allow Nixon to seize the economic offensive. As it happened, the deepening international monetary crisis provided him his opportunity. In early May 1971, the German effort to support the dollar became so expensive that the Bundesbank gave up the effort and floated the mark. On 8 May 1971, a Treasury team set up by Connally presented a secret contingency plan, proposing ways in which the United States could use the monetary crisis to bend the rest of the trading world to its will (item 152). But the money markets quieted, and it appeared the system might muddle through again. In early August, when foreign central banks faced another punishing run on the dollar, Connally was ready. Among the most interesting parts of this volume are the editorial notes, based on taped White House conversations, describing how Connally persuaded Nixon to implement the Treasury’s contingency plan and to implement it quickly (pp. 453–60).

On 13 August 1971, Nixon packed up his economic advisers for secret discussions at his retreat in Camp David. On the night of Sunday 15 August, back from the mountain, Nixon stunned the world with a televised speech that attempted to solve the whole gamut of his economic problems. On the domestic side, Nixon announced a three-month freeze of wages and prices to combat inflation, tax cuts to stimulate the sluggish economy, and expenditure reductions to reduce the budget deficit. On the foreign side, Nixon closed the gold window, suspending the fiction of dollar convertibility. He also imposed a 10-percent surcharge on imports, doubling the average effective tariff on dutiable goods. Closing the gold window, Nixon hoped, would be a prelude to a major realignment of currencies that would make American exports more competitive. Imposing the 10-percent surcharge would provide a club to bludgeon allied nations into reducing barriers to American goods and paying more for the common defense. Nixon had done nothing less than declare economic warfare against America’s allies, in particular West Germany and Japan.

The most useful sections of this volume document Connally’s extraordinary efforts during the waning months of 1971 to muscle America’s erstwhile partners into line. “We were generous in our years of prosperity, and now we expect to be generous in sharing our problems,” Connally told the Group of Ten in September. “That’s what friendships are for.” In return for lifting the import surtax, Connally demanded concessions on currency, trade, and defense. Connally’s main goal was a giant swing in the U.S. export balance, from a $4 billion deficit to a $9 billion surplus, shifting jobs from the Allies to America and the balance of payments from deficit to surplus. Connally refused to specify the precise concessions he expected from the others, except to say that the United States declined to share the political burden of currency realignment by increasing the gold price of the dollar, as the Europeans were demanding. Raising the dollar price of gold would force the U.S. to accept some of the political cost for the depreciation of its currency. When the others refused to negotiate under the threat of the 10-percent import surtax, negotiations bogged down. That was fine with Connally. The longer the impasse lasted, he believed, the more the others would feel its damaging effects, and the more likely they would be to settle on American terms.

Documents in this volume suggest the extent of opposition to Connally’s brutal tactics, not only in Europe and Japan, but also within the U.S. government. Robert Hormats of the National Security Council (NSC) staff warned National Security Adviser Henry Kissinger that maintaining the import surcharge would hurt foreign economies, antagonize foreign governments, jeopardize American security interests, and possibly provoke a protectionist reaction (items 174, 182, 188). In mid-November, while Connally was still playing his waiting game, Peterson suggested to the president that the time might have come to deal (item 195), and Federal Reserve Chairman Arthur Burns warned Nixon of a possible European recession (item 198). At meetings on 23 and 24 November, Nixon informed Connally that he would break the logjam in his summit with President Georges Pompidou in December by conceding an increase on the dollar price of gold (Item 203). Connally continued to press for significant concessions on trade in return, but by the time Nixon met Pompidou in the Azores on 13–14 December, Nixon had lost interest. Nixon agreed to depreciate the dollar by raising its gold price from $35 an ounce to $38. Pompidou offered no concessions on trade, agreeing only to future negotiations. Connally’s offensive to force open the markets of the world had ended in a whimper.

All that remained was to negotiate new exchange rates, which was done by the G-10 ministers at a conference at the Smithsonian Institute on 17–18 December 1971. According to Volcker’s later estimate, Connally achieved a trade-weighted depreciation of the dollar “a little under 8 percent,” approxi-
mately half of his original goal. Currency exchange rates would again be fixed, with governments pledged to defend them. But the dollar would remain unconvertible into gold, at least temporarily. Nixon made a surprise appearance at the end of the Smithsonian meeting to hail “the most significant monetary agreement in the history of the world” (p. 599). Little more than a year later, soaring U.S. trade deficits again set the currency markets spinning. In March 1973, George Shultz, who had replaced Connally at the Treasury, presided over the final abandonment of Bretton Woods by replacing it with a regime of flexible exchange rates. The value of currencies would now be determined daily in the private currency markets, with governments free to manipulate them at their discretion. That year, as the dollar continued to plunge, the administration learned, to its sorrow, that depreciation brought not only the supposed blessing of increased exports, but the curse of rising inflation as well.

The editors of this volume culled documents from the Nixon presidential papers and the records of the state and treasury departments. Scholars will find many of them useful, but all of them together disappointing. Only with difficulty will they be able to discern one of the most remarkable stories in the history of economic diplomacy. The editors needed a stronger focus, clearer criteria for selecting documents, and a surer sense of what was important. Lacking these, they have produced a volume that is, in the main, a missed opportunity.

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