

Working Paper

Before the Plaza: The Exchange Rate Stabilization Attempts of 1925, 1933, 1936 and 1971

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1. Introduction

The Plaza Accord is controversial.¹ On the one hand it is hailed as “perhaps the high-water mark of international economic co-operation over the past 40 years” (in the words of Beattie 2010). On the other it is impugned as having had little effect on currency values, as heightening instability rather than reducing it (by causing the dollar to overshoot in the opposite direction), and even as having been indirectly responsible for the Japanese crisis and lost decade (as recounted if not exactly endorsed in IMF 2011).

Exchange rate stabilization negotiations and agreements are always controversial. They are economically complex and politically fraught, since rhetoric is easy to offer while commitments are difficult to keep. They tap into deep-seated beliefs about whether markets produce desirable equilibria and, if not, whether intervention can improve observed outcomes. They prompt the question, debated by academics if not also practitioners, of whether international cooperation on monetary and financial matters is more likely to be productive or counterproductive.

One episode from 1985 is not exactly sufficient evidence for resolving these disputes. In this paper I therefore consider a number of earlier episodes when officials attempted to implement agreements to move exchange rates to desired levels and stabilize them there.² In 1925 the United States (or more precisely the Federal Reserve Bank of New York) sought to cooperate with the United Kingdom in reversing the postwar depreciation of sterling against the dollar and stabilizing the bilateral exchange rate at pre-World War I levels. In 1933 the major countries of the world, led by the U.S., UK and France, sought to stabilize exchange rates and avoid another round of competitive devaluations following earlier depreciation of first sterling and then the dollar against the gold-bloc currencies. In 1936 the Americans, British and French sought to facilitate depreciation and adjustment of the franc against sterling and the dollar while preventing the American and British currencies from becoming severely overvalued and at the same time avoiding another round of competitive devaluations that might neutralize efforts to realign the franc. And in 1971 the U.S. and its foreign partners sought a stabilization agreement under which the dollar would be adjusted downward by an amount adequate to correct U.S. balance-of-payments weakness while at the same time limiting the adverse impact on foreign economies that found themselves with a stronger dollar exchange rate as a result.

¹ This paper is prepared for a Rice University/Baker Institute conference on the Plaza Accord, October 1, 2015. For the general reader: the Plaza Accord was an agreement between the French, Germany, Japanese British and U.S. governments, signed on September 22, 1985 at the Plaza Hotel in New York with the goal of reversing the previous sharp appreciation of the U.S. dollar and stabilize currencies, broadly speaking, at more suitable levels.

² Although, as we will see, there was not always a consistent definition over time of what was meant by “appropriate” or “stabilize,” not surprisingly perhaps since neither is there agreement on such terms and concepts among negotiators.

My analysis of these episodes can be thought of as an effort to put the Plaza Accord into a broader historical context. In each case I ask a series of questions about these agreements. First, what was the problem in foreign exchange markets that governments were trying to solve, to what extent was there a common diagnosis of that problem, and how widely was it shared? Second, what were the obstacles to a cooperative solution? Third, how successful were the representatives of different countries in achieving their goals? Fourth and finally, were there unintended consequences, positive or negative, of their agreement?

In the conclusion I explore what light this historical analysis sheds on the Plaza Accord.

2. Sterling-Dollar Stabilization in 1925

1925 marked the culmination of efforts on the part of the United States to intervene in international financial markets with the goal of stabilizing the sterling-dollar exchange rate at prewar levels. Its intervention was successful but had unintended consequences.

World War I was more expensive for Great Britain than the United States, Britain having among other things having entered the war three years earlier. As soon as gold exports were embargoed in 1914, sterling depreciated against the dollar, but it was held at a relatively modest discount for the duration of the war through a combination of intervention and controls. With the abandonment of controls in 1919 sterling depreciated further, reaching a low of \$3.60 against the dollar, down from a prewar parity of \$4.86.

This floating exchange rate was widely viewed as suboptimal, given favorable perceptions of the performance of the prewar gold standard. The U.S. had become more of an international commercial and financial power as a result of the war, and American officials saw restoring stable exchange rates as essential for promoting U.S. exports of commodities, merchandise and finance. Sterling being one of the two leading international currencies along with the dollar, they viewed stabilization of the sterling-dollar rate as a key event that would lead other countries to follow. British officials, as the stewards of an even more outward-oriented economy, shared these concerns. British officials further saw return of the bilateral sterling-dollar rate to prewar parity as desirable for enhancing the position of London as an international financial center and as a matter of prestige.³

Starting in 1921, sterling was gradually pushed up in the direction of the prewar dollar parity through the maintenance of a relatively restrictive monetary policy (high interest rates) in the UK. But restrictive policies limited investment and made for slower growth, which raised questions about their sustainability. Sterling appreciation weakened the balance of payments and limited the Bank of England's accumulation of free gold reserves that might be used as a buffer against shocks. The hope was that once the prewar parity was reached, positive credibility effects might allow these constraints to be relaxed. But getting there was a problem.

Anglo-American cooperation was facilitated by the fact that key policy makers in the two countries shared these priorities and concerns. It was eased by the fact that there were only two

³ Although, as is well known, there were a few prominent dissenters from this view.

countries involved in the negotiations.⁴ A complication was that the main proponent of coordinated intervention was the Federal Reserve and not the U.S. Treasury (where it is customary for treasuries to take the lead in exchange-rate management and agreements in the United States as in other countries) and, in particular, that the motive force was the Federal Reserve Bank of New York and not the Board of Governors (between which relations were not easy).

The main mover was Benjamin Strong, the influential governor of the New York Fed. Strong was an internationalist by temperament. With experience on Wall Street, he appreciated the advantages to New York as a financial center of successful restoration of an international system of stable exchange rates. He was also on close personal terms with Montagu Norman, governor of the Bank of England. Herbert Hoover, a harsh critic, later called Strong “a mental annex to Europe.”

By 1924 more than five years had passed since the conclusion of the war. Germany had stabilized the mark and other countries had stabilized their currencies at various levels, suggesting that, absent early action to restore parity against the dollar, sterling and London might lose their traditional positions.

Strong and Norman therefore negotiated how to engineer the final push. Norman agreed to keep interest rates at high levels. Strong, for his part, got his Fed colleagues to agree to a series of discount rate cuts. With leadership from New York, the Reserve Banks reduced their discount rates from the 4 ½ per cent levels prevailing since early 1923 to 3-4 per cent between May and October of 1924. In a 1924 statement prepared for the House of Representatives Committee on Banking and Currency, Strong cited international considerations as a rationale for lower discount rates and expansionary open market operations. These initiatives were designed “to render what assistance was possible by our market policy toward the recovery of sterling and resumption of gold payment by Great Britain.”⁵

In addition, the Open Market Investment Committee authorized the New York Fed to purchase \$300 million of Treasury bonds, pushing down yields and encouraging capital and gold to flow across the Atlantic to Britain. But there was still the immediate need on the part of the Bank of England for an additional cushion of reserves.⁶ To meet it, in early 1925 the Federal Reserve Bank of New York provided a \$200 million line of credit to the Bank of England in exchange for an equivalent amount of sterling deposit credit, while Strong further encouraged J.P. Morgan & Co., with which he was on friendly terms, to provide a supplementary \$100

⁴ The reality was a bit more complicated, but only a bit, with negotiations over the Dawes Loan for Germany and stabilization loans for other European countries (the latter mainly through the League of Nations, of which the U.S. was not a member).

⁵ 69th Congress, 1st session, Stabilization, Hearings on H.R. 7895 before Cmomitee on Banking and Currency, part 1, p.336.

⁶ There was some disagreement within British circles about whether a cushion was needed for the return to gold. Norman was strongly of the view that a cushion of at least an additional \$300 million was needed. Otto Neimeyer (then still at Treasury, not yet at the Bank of England) disagreed on the grounds that the conditions attached to the American support, either implicitly or explicitly (that the Bank of England might be asked to raise interest rates) were undesirable. Neimeyer also doubted that \$300 million would make much difference or alleviate the need for the Bank to raise interest rates in response to market pressure. Sir Warren Fisher (permanent secretary to the Treasury, the most senior civil servant at Treasury) disliked it because Britain would become indebted and subordinate to another country. Moggridge (1971), pp.79-81.

million credit to the British government.⁷ Sterling continued to strengthen, and with this U.S. support in place it was stabilized at the prewar parity in April 1925.

These international actions were controversial at the time and became even more controversial later. Keynes, among others, criticized the \$4.86 rate as dangerously overvalued. Commerce Secretary Hoover objected that Strong's internationally-motivated policies were fueling financial excesses in the United States. In his memoirs he pointed to the rapid growth of loans to stock brokers and dealers and sharp appreciation of share prices already in 1925.⁸ In November he protested to the nominal head of the Federal Reserve Board, Daniel Crissinger, that Strong's policies were fueling speculation. Extraordinarily, he wrote members of the Senate Banking and Currency Committee, which had oversight of the Federal Reserve, making the same objection, and even drafted a letter for a prominent senator to sign and send on to the Fed. He enlisted the support of two allies on the Board of Governors, Adolph Miller, formerly professor at the University of California, Berkeley, and Charles Hamlin, founding governor of the board. But none of this reversed prior policy.

The consequences of the agreement were not entirely as expected. The British balance of payments failed to magically strengthen, forcing another negotiation among central bankers in 1927, this one involving not just Strong and Norman but also Hjalmar Schacht of the Reichsbank and Charles Rist of the Banque de France. In a renewed effort to prop up sterling, Strong and Norman asked the German and French banks to cut interest rates (which they refused to do) and to refrain from converting their sterling securities into gold in London (which they agreed to do, but only temporarily). Consequently the burden of adjustment fell on Norman and Strong. The former agreed "to do whatever it takes" (in Mario Draghi terms) to maintain the sterling parity, while the latter once more cut interest rates and purchased securities to induce gold and capital to flow toward London.

Together their actions bought four more years of sterling stability. But none of this addressed the currency's underlying weakness. When the Great Depression hit and sterling came crashing down, it essentially brought the dollar down with it.

In addition, there was the undesirable fillip to stock market speculation (although economists differ, as always, on how important monetary policy was as opposed to other factors for events on Wall Street).⁹ Strong had gaily told Rist that he was going to give "a little coup de whiskey" to the stock market." He ended up providing more.

The internationally-motivated decision to cut interest rates was resisted by other Reserve Banks, which were forced by the Board to go along for the first time in the history of the Federal Reserve System. This led to bad feeling and recrimination between New York and the other Federal Reserve Banks. This tension undermined their ability and willingness to work together to contain the spreading financial crisis in 1931-33.¹⁰ That the agreement between Norman and Strong was taken at a private meeting between the governor of the New York Fed and foreign central bankers and then presented to the Board as a *fait accompli* was criticized in House of

⁷ Morgan had been an agent for the British government during the war and now had an interest in rebuilding international financial business between London and New York, in which it hoped to play a leading role.

⁸ Hoover (1941), p.9. This is where the aforementioned "mental annex" remark appears.

⁹ The case is perhaps most strongly made by Rothbard (1963).

¹⁰ I describe these consequences in Eichengreen (2015).

Representatives hearings in 1928.¹¹ Miller, in a 1935 address, argued that the decision gave “a further great and dangerous impetus to an already overexpanded credit situation, notably to the volume of credit used on the stock exchanges...”¹² Hoover, in his memoirs, essentially blamed the decision for not just the Great Crash but the Great Depression.

This, clearly, is going a bit far (Hoover had an obvious interest in deflecting blame). Still, the successful 1925 stabilization agreement is a cautionary tale. It cautions against elevating exchange rate stabilization to a primary goal of policy, especially when its pursuit causes policy to be diverted from more fundamental domestic goals like the maintenance of price and financial stability. It shows how policy makers, once they commit to moving the exchange rate and holding it at a certain level, may be forced to double down on their bets. It is a warning that an exchange rate agreement that does not have the full backing of governments will not be fully credible and may not hold.

3. Failed Stabilization Effort of 1933

Britain’s abandonment of the gold standard under duress in September 1931 induced a score and more of countries to follow. It then took more than six months for monetary policy to be reoriented toward the needs of internal stability. Sterling fell as low as \$3.40 before recovering to the \$3.80-\$4.00 range. Over the first half of 1932 the Bank of England cut interest rates from 6 to 2 per cent. At mid-year Treasury established the Exchange Equalisation Account to intervene in the foreign exchange market (officially to prevent undue fluctuations, in the American view to keep the floating pound down), and the Chancellor of the Exchequer, Neville Chamberlain, assumed effective control of monetary policy.

The depreciation of sterling, as a reminder that the commitment to the prevailing set of exchange rates was not irrevocable, ratcheted up the pressure on the United States. Expectations that the new president, Franklin Delano Roosevelt, would devalue led to a run on the dollar during the interregnum between the election in November 1932 and inauguration in March 1933.¹³ That run in turn forced the bank holiday as Roosevelt’s first act on assuming office and led to the decision to “temporarily” embargo gold exports.

Against this chaotic backdrop, the leaders of the principal countries sought to reach an agreement on currency stabilization. The idea of an international conference to address currency, trade and related issues had been floating around since at least 1930 and arose repeatedly in bilateral meetings among leaders. An international conference in Lausanne in July 1932 concluded with agreement to call another conference to consider currency stabilization and related issues; this was eventually scheduled for London in June 1933.¹⁴

The perception that exchange rate instability was a problem that contributed to the collapse of international trade and lending was broadly, if not universally, shared. French officials, many of whom had first-hand experience with exchange rate volatility, inflation and financial instability in the 1920s, argued strongly for the restoration of fixed rates. Not

¹¹ Hearings Before the Committee on Banking and Currency of the House of Representatives, “Stabilization,” Seventeenth Congress, First Session, HR11806.

¹² Miller (1935), p.449.

¹³ See Wigmore (1987).

¹⁴ Kindleberger (1973), pp.200-1.

incidentally, France was now suffering growing problems of overvaluation and deflation as a result of the depreciation of first sterling and now the dollar. Other members of the so-called gold bloc of countries shared its concern.

British officials too worried about exchange rate instability. More specifically, they worried that FDR might aggressively devalue the dollar and push the sterling-dollar rate back to \$4.86 or even above. Agreement by the United States not to intervene too aggressively in gold and foreign exchange markets was desirable from this point of view. At the same time, British policy makers, having seen the advantages of increased policy space, refused to limit their own monetary room for maneuver. In effect, they were happy to encourage an exchange-rate-stabilization agreement if it left their own hands untied.

Roosevelt's views were unclear to the others because they were unclear to the president himself. As Herbert Feis, economic advisor to the State Department, wrote of the president later, "His ideas veered and waffled. Even now, with many records opened, it is not easy to trace their gyrations."¹⁵ In April FDR seemed favorably predisposed toward the gold standard and exchange-rate stabilization, assuming that countries could agree to cooperate on the necessary reflationary measures. But by May and June he had become impressed by the very positive impact of depreciation of the dollar on commodity prices and the stock market.¹⁶ He had also grown more pessimistic as a result of his bilateral meetings with European officials about the scope for cooperative reflationary action.¹⁷

When the American representatives first produced a temporary stabilization agreement then somewhat unexpectedly promised a proposal for stabilizing exchange rates on a permanent basis, FDR transmitted his famous "bombshell message" of July 3rd denigrating fixed exchange rates as "old fetishes of so-called international bankers" and blowing the American delegation and the conference out of the water.¹⁸ This symbolic act was criticized as signaling U.S. isolationism and indirectly encouraging Italian ambitions in Ethiopia, Japanese ambitions in China, and German ambitions in Europe. Roosevelt, for his part, followed the example of Britain and Chamberlain, using his powers under the Thomas Amendment to the Farm Relief

¹⁵ Feis (1966), p.144.

¹⁶ Kindlebergerp.206 writes, "As the dollar fell on international exchanges in May – going from \$3.85 to the pound on April 29 to \$4.00 on May 31 – Roosevelt became less and less interested in stabilization....He was prepared to agree on the dates of the conference – in mid-June. Nothing else was decided."

¹⁷ Other advisors to the administration such as James Warburg of the State Department, Oliver Sprague of the Treasury, and George Harrison of the New York Fed continued to favour reestablishment of fixed rates and the gold standard, but they did not convince the president.

¹⁸ Kindleberger (1973) writes "The deal worked out among the financial representatives called for the dollar to be stabilized at \$4.00 to the pound and 0.04662 to the franc, with a 3 per cent spread on either side....Each of the three central banks would support its currency by selling gold, up to a limit of four or five million ounces, equivalent to \$80-\$100 million. When this was used up, the agreement would be reexamined." A further problem here was the American delegation in London had failed to keep the president and his advisors informed of its progress. This led FDR and his circle to misinterpret a temporary agreement to stabilize exchange rates for the duration of the conference as a permanent exchange rate accord. Kindleberger goes on: "The news of the [temporary] stabilization leaked to the press, and the exchange market firmed from \$4.12 to \$4.02; the commodity and stock markets declined. The Committee for the Nation sent President Roosevelt a telegraph calling for the dollar to be cut 43 per cent, based on calculations for restoring U.S. prices, which implied a pound rate of \$5.70. Roosevelt sent the delegation telegrams on June 17....saying that \$4.00 was unacceptable..."

Act to seize the monetary reins. Starting in October FDR, through the agency of the Reconstruction Finance Corporation, purchased gold on the open market, pushing down the dollar and returning the sterling/dollar rate to approximately pre-1931 levels.

The fundamental mistake, in fact committed by Hoover and not Roosevelt, was to call the conference in the first place. Doing so raised expectations, which were bound to be disappointed given the very different diagnoses and prescriptions of representatives of different countries. The priority and solution in the eyes of the French was stabilizing exchange rates, ideally at pre-devaluation levels, and the problem was the reluctance of other governments to pursue the deflation necessary to meet those exchange-rate commitments. For the British, in contrast, deflation was perceived as the problem, not as the solution, and the exchange rate was properly viewed as a variable to adjust so as to carry out Chamberlain's promise to return prices to 1929 levels.¹⁹

Hoover, for his part, essentially agreed with the French and failed to comprehend that any president, including FDR, might fail to share his view. He made the fatal mistake of agreeing to the conference before an election, which he lost, which of course meant that he could not commit the U.S. to the conference agenda. All participants in some sense lost face as a result of subsequent events.

The bottom line is: avoid convening ambitious exchange-rate-stabilization negotiations in the absence of a modicum of agreement on the nature of the problem and what needs to be done. That agreement should encompass the relevant countries (France as well as the U.S. and UK in the present instance) but also extend within governments (there should be reason to expect that it will be shared not just by current policy makers but also their successors).

4. The Tripartite Agreement, 1936

In January 1934, having successfully exerted upward pressure on commodity prices, Roosevelt re-pegged the dollar to gold at \$35 an ounce (up from the \$21 prevailing before 1933), although the U.S. now stood ready to pay out gold on demand only to foreign official holders that similarly maintained convertibility. FDR having pushed down the exchange rate, the sterling/dollar rate had recovered to \$4.86 and even a bit higher (appropriately, it can be argued, given that the U.S. depression and deflation were even more serious than the British).

Devaluation of the greenback and by the other members of the dollar area now intensified the pressure on the currencies of the gold bloc that still maintained convertibility at an unchanged gold price. The Belgian franc was the first such currency to fall in 1935.

¹⁹ Meltzer (2003) offers a different interpretation, with which I do not agree. According to Meltzer, the British, French and Americans all agreed on the desirability in principle of the gold standard and fixed exchange rates but disagreed fundamentally on their appropriate level, the U.S. and the UK both wanting currencies that were devalued against foreign currencies, including against one another, while the French wanted to see pre-devaluation exchange rates restored, or at least the extent of U.S. and British devaluation severely limited. My view is that the parties disagreed fundamentally on the importance of exchange rate stability, where the French and the early FDR viewed it as a priority, to which price levels and internal conditions generally should be forced to adjust, while the British and late FDR attached priority to price stability (to returning prices to 1929 levels) and saw the exchange rate as a variable that should be adjusted as needed to make this possible.

Markets then trained their sights on France, not without reason. France now had an increasingly overvalued currency as a result of these exchange rate developments abroad. Successive French governments and the Banque de France had shunned all significant reflationary monetary policies, consigning the country to a deepening deflation. As unemployment mounted, support for the parties of the center-right and their orthodox policies crumbled. The result, predictable in hindsight, was the electoral victory of the Socialist-led Popular Front headed by Léon Blum.

In a sense, the situation was not unlike that in the United States three years earlier. Given the condition of the economy and the promise of the opposition party, soon to assume office, to take whatever steps were needed to stabilize prices and restart economic growth, it was not hard to see devaluation coming. At the same time, a considerable segment of the French political and financial establishment remained wedded to the gold standard, given the country's traumatic experience with a floating exchange rate a decade earlier. Blum himself, while possessing many admirable qualities, was no financial expert. Not unlike Roosevelt, he wanted to satisfy the demands of those who saw merit in maintenance of the gold standard and an unchanged franc exchange rate and also those who urged economic stabilization and reflation. It was not clear, when faced by the incompatibility of the two objectives, which way he would jump.

Once Blum formed his government in June 1936 and devaluation came to appear increasingly imminent, French policy makers became animated by two further considerations. First, they were concerned that any change in the franc exchange rate should be dressed up as an international agreement rather than constituting an admission of failure by the new government. As part of that agreement they might even secure commitments of support from the British and French authorities, or so it was hoped. Second, the French sought assurances that if they did devalue the needed improvement in international competitiveness would not be neutralized by further competitive devaluations by the British and Americans or by their imposition of retaliatory tariffs.

The British and Americans, for their part, were concerned mainly that the French devaluation should not be excessive, undercutting their own competitiveness. Harry Dexter White, newly appointed to the Treasury, warned in May 1935 that France was apt to devalue by too much, creating new maladjustments. White recommended negotiating some kind of international agreement to prevent this.²⁰ At the same time, the British and Americans were also concerned that France should devalue by an adequate margin, since a small devaluation that did not restore competitiveness might do more to undermine confidence than restore it and be followed by a second devaluation, roiling financial markets.

In addition, the Americans and British again wanted to keep their options open: Britain had the Exchange Equalisation Account to intervene in the foreign exchange market if sterling's strength looked excessive; the U.S. administration possessed a similar account, and FDR had the option of devaluing the dollar further under the provisions of the Gold Reserve Act of 1934. Drummond (2008, p.201) describes how the British view, under Chamberlain, had evolved by this point: "The pound would not be [competitively] devalued, but neither would it be pegged to gold or the dollar until the world had been freed of the trading and financial barriers that had made the old gold standard unworkable." Others like Frederick Leith-Ross (chief economic

²⁰ Clarke (1977a), p.15.

advisor to the government and architect of the Treasury View) and various officials of the Bank of England continued to hanker after pegged rates, but to no avail. Similarly, others concerned with U.S. policy, for example Jacob Viner (who served as an advisor to Treasury Secretary Henry Morgenthau) and Alvin Hansen (who wrote a paper as a consultant to the State Department in 1935), saw exchange rate uncertainty as a major factor discouraging trade and hindering recovery and were more positively inclined toward a meaningful exchange rate arrangement. As with proposals for such an agreement in 1933, the president was not convinced. FDR's reaction to Hansen's proposal for a stabilization agreement was that "the man should absolutely be fired."²¹

By June 1936, Morgenthau was convinced that the French should devalue before being forced into doing so by the markets. But the Blum government needed the act to be dressed up in a diplomatic cloak and, consequently, resisted until September. The French pushed for a joint agreement between the three governments specifying new central rates surrounded by fluctuation bands, a bit wider than before, and commitments of bilateral support between the participating exchange equalization funds.²² But this was more than the U.S. and British governments could accept: both now saw the exchange rate as properly subordinate to domestic price stability and economic recovery and were not willing to tie their policies to France.²³

In the end the French got not a joint declaration but three separate, if harmonized, statements by the three governments. The three statements dated September 26th implicitly recognized the new exchange rate of 105 to the pound (where the pound was now at roughly \$5.00) as broadly appropriate. The statements contained no numbers, instead speaking in general terms of "consultation" and "cooperation."

Morgenthau hailed the agreement as the "greatest move taken for peace in the world since the World War," anticipating Richard Nixon's characterization of the Smithsonian Agreement as "the greatest monetary agreement in the history of the world." The reality was more modest. Although the statements spoke of "consultation" and "cooperation," there was no commitment to cooperate in holding exchange rates at those levels. Over the winter of 1936-7, the French intervened to prevent the franc from falling further, while the British intervened to prevent sterling from strengthening excessively. The U.S. Treasury sterilized gold inflows starting in December 1936 to prevent the U.S. price level from rising faster (to prevent the U.S.

²¹ Clarke (1977a), p.12.

²² On September 9th, just before devaluing, the French submitted a text to Washington and London proposing an agreement whereby the three currencies would be stabilized against one another, and that the specified limits "shall not be modified except by common agreement or subject to notifying the contracting powers in the case of exceptional and unforeseen circumstances, the final objective of the contracting parties being the general return to the international gold standard when the conditions necessary are found to be realized." Drummond (2008), p.206.

²³ Negotiations started with a visit in June 1936 by Emmanuel Monick, France's financial attaché in London, to Washington, DC. Monick told the U.S. that France would devalue, and FDR agreed that the US would not retaliate so long as the French devaluation was not excessive and US prices would not fall. The problem, Monick conveyed to the Americans, was that the British were unwilling to make a similar commitment. The British sought a formula whereby they could bless the French devaluation, and encourage the French not to make it excessive, while maintaining their room for maneuver. In July they promised not to retaliate by devaluing the pound or by imposing discriminating duties so long as France chose a rate of not more than 100 francs to the pound. At the same time, in a letter to the French at the end of July, Chamberlain stated in no uncertain terms that he was not providing a guarantee that sterling would be stabilized at any particular level. See Clarke (1977a), p.30 et seq.

real exchange rate from becoming overvalued).²⁴ But there was no overt cooperation between governments. Each country was on its own. And the weak currency country, France, was forced into a further devaluation in 1937.

There are few formal assessments of the effects. Eichengreen and James (1991) find that exchange rates tended to be less volatile after the Tripartite Agreement than before.²⁵ An interpretation is that exchange rates had been restored to more appropriate levels, obviating the need for more sharp changes in rates like those affecting sterling in 1931, the dollar in 1933 and the franc in 1936 (with the renewed depreciation of the franc in 1937 constituting a partial exception).

The lesson of the Tripartite Agreement is to avoid excessively ambitious commitments that you may be unable to meet. The Tripartite Agreement moved exchange rates in more sustainable directions and may have thereby had a modestly stabilizing impact on foreign exchange markets. It avoided an excessive devaluation that might have elicited currency or tariff retaliation. It helped make realignment palatable to the French by allowing them to package it, for domestic consumption, as part of an international agreement, while not committing the governments involved to subordinate their domestic objectives to cooperation on exchange rates in any meaningful sense. Sometimes, in currency stabilization agreements, less is more.

5. 1971 Smithsonian Agreement

The story of the Smithsonian negotiations of December 17-18, 1971 is sufficiently well known that it can be summarized briefly here, in a manner tailored to the questions in the introduction. The problem was not unlike that in 1936. Then the French franc had been overvalued, and the challenge for negotiators was to agree on a realignment that was sufficient to correct this problem but not so large as to create serious problems for the country's neighbors. It was to prevent other countries from taking offsetting steps that might neutralize the improvement in French competitiveness. And it was to agree on the structure of the exchange rate system now that the currency formerly at its center (in this case the franc) was no longer tied to gold.

In 1971 the problem was the dollar that was overvalued in that the U.S. was hemorrhaging gold reserves.²⁶ The challenge was to get foreign countries to accede to a devaluation of the dollar sufficient to stem U.S. gold losses and not to offset any increase in the dollar price of gold by depreciating their currencies commensurately.²⁷ It was to prevent the Congress from imposing new import duties if other governments failed to go along. And it was

²⁴ U.S. gold sterilization policies are discussed in Irwin (2012).

²⁵ Lewis (1949) agrees with this assessment. Sauvy (1967) and Drummond (1979) disagree, concluding in favor of no discernible impact. In addition, international real interest rate differentials were smaller due to a decline in covered interest differentials, exchange risk premia and real exchange rate variability.

²⁶ The source of those gold losses need not detain us here. One interpretation was that expansive U.S. monetary and fiscal policy was responsible for dollar overvaluation and the U.S. balance-of-payments deficit. Another view, known as the Triffin Dilemma, was that U.S. deficits were intrinsic to the operation of the system, given the growing demand of other countries for international reserves, which could be met only by their accumulation of U.S. dollars and/or conversion of the latter into gold. The second view pointed to the need for an increase in the dollar price of gold, while the first highlighted the need for a change in dollar exchange rates and, to maintain them, appropriate adjustments in U.S. monetary and fiscal policies.

²⁷ "There were strong doubts," as Volcker later put it, "about the willingness of other countries to permit a sizable adjustment, however initiated." Volcker (1978-79), p.6.

to agree on the structure of the new system once the dollar was no longer freely convertible into gold at a fixed price.

The belief that dollar devaluation was needed was widely shared, although engineering the devaluation had to surmount a collective action problem: other countries fearing a loss of competitiveness generally preferred that the dollar be devalued against someone else's currency rather than their own. This created an obvious argument for an international conference where a set of new parities against the dollar could be collectively agreed. The U.S. employed good-cop, bad-cop tactics to elicit agreement from other countries to convene the conference at the Smithsonian. The bad cops, President Nixon and Treasury Secretary John Connolly, closed the Gold Window in August, sounding the death knell for gold convertibility, and imposed a 10 per cent import surcharge, signaling that they would use trade policy as a sanction against countries that hesitated to negotiate.²⁸ The good cop, Paul Volcker, traveled to Europe to reassure foreign leaders that the U.S. was interested in a mutually-beneficial solution.

The Smithsonian Agreement included the necessary realignment of the dollar, where other countries saw a collective 10 per cent appreciation of their currencies, although some (like Germany and Japan) contributed more than others depending on the perceived strength of their economies and their dependence on U.S. foreign policy protection.²⁹ The dollar was realigned to more appropriate levels. Its adjustment was not offset by other countries. The U.S. did not have to resort to tariffs and other undesirable expedients to achieve this goal; the import surcharge imposed in August was lifted following the successful conclusion of negotiations. It was "no mean feat to manage a devaluation of the proud dollar in a way that did not turn American opinion and policy inward," as Volcker (1978-79, p.6) later put it.³⁰

The new system was a compromise between the champions of fixed and adjustable exchange rates. Other currencies were again linked to the dollar, but surrounded by wider fluctuation bands than before ($\pm 2\frac{1}{4}$ versus ± 1 per cent). The dollar was no longer freely convertible for official foreign holders of dollars as had been the case before August (something that was reflected in the fact that the market price was now significantly higher than the official price). This compromise reflected the fact that there was less than full agreement on how the post-Bretton Woods System should be structured. There was strong disagreement within the U.S. administration between the proponents of fixed and floating exchange rates (Arthur Burns and Volcker on the one hand, George Schultz on the other). As a result, the U.S. was unable to make a firm commitment to either fixed or flexible rates.

Similarly, there were significant differences between other countries over how much exchange rate flexibility was appropriate. West Germany had already adjusted the deutschmark/dollar exchange rate more than once as necessary for the maintenance of price

²⁸ Johnson (1973) refers to U.S. use of "its muscle power to force the others to make exchange rate adjustments that the United States considered necessary for its own interests but the others were reluctant to make."

²⁹ The French franc was revalued against the dollar by 8.57 per cent, the German deutschmark by 13.57 per cent, the yen by 17.9 per cent. The exact numbers reflected a compromise between Nixon and French President Pompidou, who met in the Azores to hammer out their differences prior to the Smithsonian conference.

³⁰ Volcker later argued that the weakness of the Smithsonian Agreement was that other countries were reluctant to see larger revaluations against the dollar. Feldstein (2013), p.106. Others, like the present author would argue that a larger realignment, even had it been feasible, would not have resolved the underlying contradictions of the system and would have only put off the day of reckoning.

stability; increasingly it saw exchange rate stability as less of a priority than the pursuit of internal stability, so defined.³¹ Canada, reflecting its favorable experience with floating, recommended wider adoption of a flexible system. France, in contrast, remained wedded to fixed exchange rates and gold convertibility (reflecting memories of the interwar history recounted above).³² Japan saw itself as an export economy; while it was prepared to revalue the yen as much for political as economic reasons, it was reluctant to see generalized floating for fear that this would interfere with the growth of international trade (see Angel 1991).³³

The Smithsonian agreement did not include any commitment on the part of the United States to run a particular set of monetary and fiscal policies so as to defend the new system of parties. It did not entail a commitment to keep inflation in a specified range. As such, it focused on ends without due attention to means.³⁴ Already in 1972 there were complaints that American inflation was excessive (reflecting the pressure Nixon was placing on the Federal Reserve in an election year) and was infecting other countries. U.S. capital outflows resumed. Under the circumstances, it is not surprising that “the greatest monetary agreement in the history of the world” was ephemeral. On February 12, 1973, the new Treasury Secretary, George Schultz, announced a ten per cent devaluation of the dollar (an increase in the price of gold from \$35 to \$42.22 an ounce.) This only encouraged speculation against what remained of the parities negotiated in December 1971.

By the summer of 1973, after a bit more than a year, the new system of parities had collapsed. The Smithsonian Agreement left little in the way of an enduring legacy.

6. Implications for the Plaza

Other papers (at this conference and elsewhere) analyze the Plaza Agreement in more detail. Here I merely suggest how the Plaza should be viewed in light of the history of exchange-rate-stabilization agreements.

A first implication of that history is that policy makers pursue exchange rate targets, subordinating their pursuit of more fundamental goals of policy like price stability and high employment, at their peril. In 1985 the high dollar was associated in the popular mind and, more specifically, in the minds of U.S. business leaders with the Federal Reserve’s relatively tight anti-inflationary monetary policy. There was pressure on the Fed to relax the stance of policy in order to bring down the dollar and avoid further hollowing out of U.S. industry. Given the country’s recent experience of inflation and the sacrifice made reduce the inflation rate to more appropriate levels, relaxing Fed policy in order to facilitate dollar realignment was undesirable. Public statements and limited foreign exchange market intervention in January followed by the Plaza Agreement in September facilitated that realignment without requiring an adjustment in

³¹ Thus, Germany had revalued the deutschmark in October 1969 and floated it against the dollar in May 1971. Austria moved all but simultaneously, revaluing by 5 per cent, while Switzerland revalued by 7 per cent, and the Dutch floated.

³² Thus, in the immediate aftermath of Nixon’s closing the Gold Window, Germany proposed a joint float of EEC currencies, which France opposed.

³³ In the end, the Japanese government was converted by the import surcharge and threats of more of the same (Irwin 2013).

³⁴ To paraphrase the assessment in Sachs (1986).

Federal Reserve policy.³⁵ German negotiators similarly resisted a rigid agreement that might have required them to divert monetary policy from the fundamental goal of low inflation, preferring to rely, appropriately under the circumstances, on public statements and sterilized foreign exchange market intervention. With hindsight, one wishes that U.S. policy makers had been equally cautious in the 1920s.

Another implication is that it was wise to defer convening an international meeting to discuss the exchange-rate issue until there was broad agreement among the principal three governments involved, those of the U.S., Germany and Japan, on the desirability of facilitating further adjustment in the dollar exchange rate.³⁶ There had to be a change in U.S. international economic policy leadership before this precondition was met. The experience of 1933 cautions against prematurely raising expectations and engaging in unproductive negotiations if internal divisions are likely to impede their successful conclusion. It also points to the wisdom of convening such negotiations after an election, when policy continuity can be assured, as opposed to immediately before.

In addition, agreement among governments encompassed not just principles but specific magnitudes, as in 1936. At the Plaza the U.S., Germany and Japan agreed, the available accounts suggest, on a 10-12 per cent depreciation of the dollar against the deutschmark and the yen relative to September 1985 levels.³⁷ But while there was broad agreement on the desirability of exchange rates in that range, there was little appetite for an ambitious stabilization agreement of a sort that they were unlikely to successfully maintain, given divergent conditions in the three economies. As in 1936, and unlike 1971, less was more.

Moreover, there could be constructive negotiations at the Plaza because there existed broad agreement within governments (as well as between them) about the desirability of exchange rate adjustment. This had not been the case in the United States, in particular, before 1985, when the Fed had favored action to prevent and reverse excessive dollar appreciation but the Treasury under Donald Regan, strongly wedded to free-market ideology, did not agree. Henning (1994) emphasizes continuing differences of opinion or at least emphasis within governments – how the Fed subsequently became more concerned with dollar weakness (which it feared could become inflationary) than Treasury, and how the Bank of Japan was less alarmed than the Ministry of Finance by the increasing strength of the yen (which the MOF feared could damage Japanese manufacturing). But the fact is that there was considerable agreement within governments as well as between them about the goals of exchange-rate policy, which enabled

³⁵ I leave to other papers analysis of the relative importance of these and other developments in exchange-rate movements, though I am broadly in agreement with the assessment in Frankel (1994).

³⁶ Henning and Destler (1988) suggest, in a related point, that the success of the Plaza was due in part to the fact that negotiations were organized through the G-5 (which included, in addition to the U.S., Japan and Germany, France and the UK). This avoided the large-numbers problem that would have complicated negotiations organized through the IMF or OECD. This argument is consistent with the observed contrast between the 1933 World Economic Conference and 1936 Tripartite Agreement, although some of the other episodes analyzed above fit less easily with their viewpoint.

³⁷ Frankel (1994) observes that this became a focal point for discussions as a result of “a never-released ‘non-paper’ drafted by [Assistant Secretary of Treasury for International Affairs David] Mulford for a secretary preparatory meeting of G-5 Deputies in London on September 15...” Funabashi (1988) goes further, asserting that the U.S. made a formal proposal to this effect that was accepted by the other governments.

national authorities to make more credible commitments and negotiate more productively. Again, this was very different from 1933.

Finally, the Plaza realignment worked because it was consistent with the economic fundamentals. A weaker dollar and stronger yen, in particular, was consistent with the competitive positions and needs of the U.S. and Japanese economies. The Plaza accelerated movement toward exchange-market levels consistent with those fundamentals and prevented governments from frustrating it, like the Tripartite Agreement in 1936. Those new levels, in the end, did not hold. But then neither did the Tripartite Agreement..

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