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Dismantling the cross of gold: economic crises and U.S. monetary policy

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How can a U.S. Gold Commission attempt to determine the role of gold in domestic and international systems without there being any foreign participation? . . . Audience question at the World Conference on Gold, Rome, Italy, February 1982 (Jastram, 1983)

Abstract

The advent of the Euro has put the spotlight on international monetary policy. Could a new world currency be created? Could there be a return to international fixed exchange rates? The history of the American response to the gold standard in its various forms suggests one theme. At key moments during the 20th century, the U.S. chose domestic monetary sovereignty over international obligations. This address traces the history of American attitudes toward gold from the 1890s to the present. That history suggests that creation of any currency system requiring loss of U.S. national monetary sovereignty is most unlikely. © 2000 Elsevier Science Inc. All rights reserved.

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1. Introduction

With the creation of the euro on January 1, 1999, much of the European Union's economy was united under a single monetary system with a common central bank. Existing currencies of the member states—such as the French franc, the Italian lire, and the German mark—became mere fractional representations of the euro on that date and will eventually disappear. European monetary unification eliminated the risk of exchange rate fluctuation from cross-border trade and investment flows within the euro zone. The development of the euro in the EU raises the question of whether similar currency unification could someday occur within other currency blocs such as NAFTA (or an expanded version of NAFTA if other Latin American countries become part of the agreement).

Indeed, the euro's creation raises an even larger question. Could the European experiment lead to creation of a world currency some time in the 21st century? Given the experience with flexible exchange rates during the 1980s and 1990s, this question is surely worth considering. The U.S. dollar appreciated dramatically for the first half of the 1980s in what seems in retrospect to have been a speculative bubble. At the dollar's peak, the U.S. ran a massive trade deficit and a variety of domestic trade-sensitive industries suffered injuries due to the artificial boost in their cost structure relative to world competition. During the second half of the 1980s, the process unwound as the dollar fell in value. Still more dramatic were the Mexican peso crisis of 1994 and the Asian financial crisis that began in 1997. Both of these crises featured substantial depreciation of the affected countries' currencies and severe macroeconomic effects within those nations. These episodes raised questions about the impact of global financial markets and especially about the policies and authority of the International Monetary Fund (IMF).

Since the early 1970s, the world has not really had a monetary "system." Rather, countries have followed their own approaches to managing their currencies. Some have allowed a relatively free float with little official intervention. Others have tied themselves to the dollar or some other currency or to a basket of currencies. The rigidity of these linkages has varied. Some countries have used currency boards and abandoned independent monetary policy entirely whereas others have followed an active intervention approach. Crawling pegs and varying degrees of managed floating have also been part of the currency mix. The IMF's role in this currency smorgasbord is ambiguous. That institution was created in 1944 to oversee the workings of the Bretton Woods system of fixed exchange rates, arrangements that ended abruptly in 1971. Could the IMF—now an institution without its original mission—become a world central bank in some new international currency system? Or will it remain a relatively weak institution, constrained by limited resources, complex and arcane procedures, and cumbersome decision making?

The theme of this paper is that to the extent that U.S. assent is needed, major steps toward a world currency or even a fundamental shift towards greater IMF supervisory authority is unlikely. Even a formal NAFTA currency zone is improbable unless the partner countries agree to American-made and American-based monetary policy. American history is at the root of this opinion. IMF weakness—for example—is a product of U.S. history, a history that goes back to the 19th century. Put more directly, the specter of William Jennings Bryan—the unsuccessful Democratic candidate for president in 1896—still haunts the international

monetary system and the IMF. Bryan left behind a legacy in the American polity of not subordinating domestic economic needs to the seeming imperatives of the world monetary order. He also left a lingering suspicion of financial institutions that would play a role in future reformulations of the world monetary order.

In tracing this current in American history, five episodes will be discussed. First, there is the 1896 presidential campaign and Bryan's push for free coinage of silver and the abandonment of the gold standard. Second, there is Franklin Roosevelt's temporary abandonment of the gold/dollar linkage in 1933 and his eventual boost in the official gold price the following year. Third, there is the creation of the Bretton Woods system in 1944 with its weak IMF model. Fourth, there is President Nixon's unilateral termination of Bretton Woods in 1971 and his similar termination of the short-lived successor Smithsonian international monetary system. Fifth and finally, there is the push by some elements in the Republican Party to return to gold in the early 1980s, a push that continued to echo in the form of gold proposals by Republican notables such as Steve Forbes and Jack Kemp.

All but one of these episodes—the creation of Bretton Woods—occurred against a backdrop of economic difficulties within the U.S. The 1890s and 1930s were years of economic depression. Nixon's decision occurred after a slowdown in the American economy, engineered to fight inflation, turned into outright recession. A more severe bout of recession and inflation characterized the early 1980s when agitation for a return to gold peaked. Even the Bretton Woods negotiations, which took place during wartime prosperity, occurred at a time when many feared that the U.S. economy would fall back into depression after World War II ended and war-related military expenditures were terminated.

2. Episode I. The cross of gold: 1896

Upon which side will the Democratic party fight; upon the side of "the idle holders of idle capital" or upon the side of "the struggling masses"? . . . You come to us and tell us that the great cities are in favor of the gold standard; we reply that the great cities rest upon our broad and fertile prairies. Burn down your cities and leave our farms, and your cities will spring up again as if by magic; but destroy our farms and the grass will grow in the streets of every city in the country. . . . We will answer their demand for a gold standard by saying to them: "You shall not press down upon the brow of labor the crown of thorns; you shall not crucify mankind upon a cross of gold."

William Jennings Bryan at the Democratic Party convention of 1896
(Bryan 1896 [1971], vol. II, pp. 199–206)

American history in the 19th century, and even before, was marked by tensions over the monetary system, banking, and debtors (often agricultural) versus creditors. Shay's rebellion in 1786 through 1787, for example, was a debtors versus creditors clash. President Andrew Jackson's disestablishment of the Second Bank of the U.S. in 1832 ended chances for a nascent central bank to develop for the next eight decades. The Jackson episode set a pattern of suspicion of purported monetary conspiracies—tied to such controversies—that continue to this day (Kazin, 1995, p. 20). In the late 19th century and early 20th century, the alleged conspiracy was often linked to Britain as the center of world finance and/or to Jewish

bankers' plots or just to Wall Street. However, the subsequent Panic of 1837 also gave rise to an early movement for fiat or paper currency as opposed to specie-based money (Goodwyn, 1978, pp. 13–14).

During the American Civil War, both sides—north and south—abandoned the gold standard and financed the war with paper money creation. Substantial inflation resulted that tended to reward debtors and penalize creditors. The “greenback” episode of inflation during the war created an inflationist interest group within the (then) large agricultural sector that could draw on earlier Jacksonian-era thinking. Post-Civil War moves to return to orthodox monetary rules were resisted and depicted as conspiratorial.

Nonetheless, the U.S. returned to the gold standard in stages beginning with the official demonetization of silver in 1873 (“The Crime of ‘73” to opponents). By that time, deflation had already led to a new political movement—the Greenbackers—that favored an end to gold backing and the issuance of paper money in its place. By the 1880s, the Greenback movement had largely dissipated. Other proposals arose uniting agrarian discontent with the money issue. A noteworthy example was the “subtreasury” plan whereby farmers would deposit crops in a federal institution and receive monetary certificates in return (Goodwyn, 1978, pp. 109–113). Greenbackism left imprinted on the American polity a significant inflationist component—linked to allegations of international and domestic banking conspiracies—which remained to reignite in the next major economic crisis, the depression of the 1890s.

As the Greenbackers as a political party declined, new agricultural political movements arose. A variety of causes were adopted by these movements as they coalesced into the Populist Party and other entities. Their demands varied, but at times included such items as the adoption of a progressive income tax, government ownership of railroads and telegraph systems, and the 8-hour day. Most important from an international financial perspective was a demand for free coinage of silver at a silver price set high enough to guarantee significant monetary expansion. The new party appealed to segments of both the Republican and Democratic electorate but ultimately—in the candidacy of William Jennings Bryan in 1896—became fused with the Democrats.

A lawyer by training, Bryan was a two-term Nebraska Democratic congressman who had been unsuccessful in a bid for the Senate. After his congressional career ended, he became a journalist for a silverite newspaper but remained active in Democratic politics. Bryan considered his various political causes to be reflections of “applied Christianity” tied to his fundamentalist religious beliefs (Smith, 1975, pp. 17–40). He became converted to the cause of free silver as a congressman, a cause that—among other benefits—produced campaign contributions and support from western silver mining interests (Cherny, 1994, p. 41). However, as a party, the Democrats—under incumbent President Grover Cleveland—remained officially committed to the gold standard. All that changed at the 1896 convention when Bryan, with his “cross of gold speech”—uniting an economic message with Christian imagery—took the nomination. At the time he was only 36 years old, just 1 year above the minimum constitutional requirement for a president.

Bryan recounted the reaction to his famous speech in his memoirs: “I believe it unrivaled in any convention ever held in our country. The audience seemed to rise and sit down as one man. At the close of a sentence, it would rise and shout, and when I began upon another

sentence, the room was as still as a church. . . . The audience acted like a trained choir—in fact, I thought of a choir as I noted how instantaneously and in unison they responded to each point made. The situation was so unique and the experience so unprecedented that I have never expected to witness its counterpart” (Bryan & Bryan, 1971 [1925], p. 115).

By 1896, the depression of the 1890s was well underway and the notion of free silver had been widely popularized by such best sellers as *Coin's Financial School*, published in German, Swedish, and Norwegian for the immigrant audience as well as in English (Harvey, 1963 [1894]). The *Coin* book series featured a fictional financial expert who lectured the economic and financial authorities of the day on the virtues of free silver, defeating them all in debate. Thus, the Democratic Party platform, with its accusation that the gold standard had led to “the prostration of industry and impoverishment of the people” was sounding themes familiar to the public of that era.

Bryan's candidacy panicked the business establishment and mobilized it around his Republican opponent, William McKinley. A massive campaign chest by standards of the time was assembled for McKinley and, in the words of Republican Theodore Roosevelt, the party “advertised McKinley as if he were a patent medicine” (quoted in Cherny, 1994, p. 65). The campaign ultimately focused on the gold/silver issue. In the end, Bryan lost with 46.7% of the popular vote. He ran again—unsuccessfully—in 1900 and 1908.

By the late 1890s, however, discovery of gold in South Africa and elsewhere combined with new mining technology had substantially expanded world monetary reserves. The results were recovery and price increases in the U.S. (Friedman & Schwartz, 1963, p. 137). Free silver was no longer the burning issue it had been 1896. In 1900, the Gold Standard Act officially anointed gold as the American monetary standard. Bryan eventually conceded that the added gold supplies made the silver issue moot and went on to other causes (Cherny, 1994, pp. 104–106; Bryan & Bryan, 1971 [1925], pp. 123–124). Former populists, meanwhile—with their movement dissipated—spread out across the political spectrum (Goodwyn, 1978, pp. 323–332).

However, Bryan's 1896 candidacy put a stamp on the two major parties that remained at the time of the Great Depression of the 1930s. Republicans afterwards were the party of sound money and high tariffs. Seen from a world perspective, they seemingly supported international cooperation on finance but not on trade. Democrats were the party of cheap money and low tariffs. They seemingly supported international cooperation on trade, but not on finance. There were exceptions in both parties, that is, hard money Democrats and silverite Republicans. But the dominant money and trade tendencies remained.

The trade and money tendencies—although apparently contradictory if it is assumed that these sprung from a cooperative internationalist perspective—were not contradictory from a domestic viewpoint. After the Civil War, Democrats were the representatives of the south, with its agricultural export interests. As an importer (from the north or abroad) of manufactured goods, the virtues of low tariffs seemed obvious. Republicans, representing modern northern interests of import-competing manufacturing, could see great benefits from protection. But as representatives of financial and banking interests, Republicans opposed inflation—hence their sound money theme. Cheap money, on the other hand, appealed to debtors, especially farmers, and could be a rallying theme for Democrats during Hard Times. These domestic focuses with regard to international issues continued through the 20th century.

3. Episode II. Tarnishing the cross of gold: 1933 to 1934

Our dollar is now altogether too greatly influenced by the accidents of international trade, by the internal policies of other nations and by political disturbance in other continents. Therefore, the United States must take firmly in its own hands the control of the gold value of our dollar. This is necessary in order to prevent dollar disturbances from swinging us away from our ultimate goal, namely, the continued recovery of our commodity prices.

President Franklin D. Roosevelt, Radio speech of October 22, 1933 (Paris, 1938, pp. 168–169)

If the Depression of the 1890s was capable of pushing the monetary issue to the fore in the U.S., one could easily predict that the same pressures would arise during the Great Depression of the 1930s. Indeed, one of the oddest episodes in American monetary history took place during the initial term of Franklin Roosevelt as the newly elected president sought remedies for the Depression. Roosevelt had been governor of New York state before his election as president. And during his governorship, he made the acquaintance of George F. Warren, a professor of agricultural economics at Cornell University. Warren's agricultural background seemed an unlikely one for an advisor on issues in international finance. Yet he became a key player in determining Roosevelt's gold policy and, thereby, exchange rate policy. The upshot of Warren's advice was the setting of the gold price at an official \$35 per ounce (up from a prior \$20.67). The \$35 price remained until President Nixon closed the gold window in 1971.

In many respects, the most complete documentation of the Warren role appeared in a folksy and lengthy tribute to him in the Cornell journal *Farm Economics* written by some colleagues, including Frank A. Pearson, Warren's co-author of the (Depression-era) influential book *Gold and Prices*, an update of an earlier work (Pearson, Myers, & Gans, 1957; Warren & Pearson, 1935). The *Farm Economics* article has serious shortcomings analytically as it attempts to defend Warren's linkage of gold and farm prices against the views of those officials in the Roosevelt administration in the 1930s who had disagreed. But what the article does succeed in doing is portraying the general confusion in the New Deal administration about both international and domestic monetary policy.

Because inflation became the bugaboo of the post-World War II period, it may seem difficult to imagine that a major thrust in New Deal policy—although not one supported by all New Deal advisors and officials by any means—was to promote inflation. The slide into the Great Depression was accompanied by a drop in retail prices of about one-fourth (1929–1933). Thus, it was thought that pushing prices back up to the pre-Depression level (referred to as “reflation”) would stimulate the economy. Exactly how this was to be done seemed less important than just doing it.

One of the major pieces of legislation of the early New Deal, the National Industrial Recovery Act (NIRA), sought to push up prices and wages through a cartelization of American industry. Firms would be given confidence through market and pricing agreements whereas the antitrust laws would be suspended. They would then share their good fortune with workers through agreed-upon minimum wages and collective bargaining. Various agricultural price support programs based on a combination of mandatory reduced supply and government purchases would raise farm prices. Later in the New Deal, after the NIRA and other early legislation had been declared unconstitutional by the Supreme Court, there

came the Wagner Act promoting collective bargaining, new agricultural price-support programs, and the Fair Labor Standards Act (establishing a mandated federal minimum wage).

There were various views about how price reflation would rid the country of the Depression. Perhaps the most supportable notion was that of Yale economist Irving Fisher who connected deflation with a transfer from debtor to creditor, resulting in potential bankruptcy of the former and economic disruption. If the transfer were nullified through reflation, the damage would be undone. Note, however, that Fisher—who is identified with the American version of the quantity theory of money—would not have viewed nonmonetary means of creating reflation (cartelization, farm programs, collective bargaining) as the equivalent of monetary expansion in its effect. He was a long-time supporter of “stabilized money,” the notion that “the general level of prices” should be stabilized in nominal terms, using open-market operations and other central bank controls (Fisher, 1935, pp. 391–398; see also Fisher, 1969 [1911]). But thinking in the Roosevelt administration on how reflation should be accomplished was fuzzy. One means of price raising was seemingly as good as another, so far as the president was concerned.

And there was confusion surrounding wages versus prices. Wage reflation was rationalized as a boost to worker purchasing power that would stimulate consumption (Mitchell, 1985). Unclear was the distinction between the nominal and real wage. Raising both wages and prices by the same amount would not change the real wage. Raising prices less than wages would squeeze profits. Raising prices more than wages would reduce the real wage, presumably hurting consumption. Ultimately, it seemed that upward movements in nominal values were seen as Good Things generally but particular prices (farm prices and wages) were especially targeted.

Warren’s historical research convinced him that using gold to back the currency did not produce price stability. Gold was a commodity whose relative price could vary based on demand and supply, just as could the price of any other commodity. Thus, as he saw it, the fall in American farm prices in nominal dollar terms after 1929 was really the mirror image of a rise in demand for gold (Warren & Pearson, 1935, p. 79). Reflation of nominal dollar-denominated prices could be achieved by raising the official price of gold. Although a modern economist might have seen raising the price of gold as largely a devaluation of the dollar relative to other gold-backed currencies, Warren saw it as something more fundamental.

Even in a completely closed economy, Warren would have prescribed a change in the official gold price as a remedy to counteract deflation. Fisher, and most modern economists, however, would emphasize the quantity of money. Raising the gold price in a multicountry international gold standard would produce the usual price-raising effects associated with devaluation. If a higher price of gold led to a gold inflow from new mining or other sources, the rules of the game under a gold standard would produce an easing of monetary policy. Some of the resulting demand might then spill over into price increases of nontraded goods, apart from the immediate devaluation effect.

In contrast, Warren’s theory seemed to be that gold had special power as a *numeraire*. Prices were “really” set in gold, using the “dollar” as an arbitrary representation of a quantity of gold. “The given amount of the money commodity is given a money name so that

confusion arises. For example, 23.22 grains of gold were formerly named a dollar. But this was merely a duplicate name for 23.22 grains of gold. Naming it a dollar did not change the fact any more than naming 2000 pounds a ton changes it" (Warren & Pearson, 1935, p. 81). In Warren's view the numeraire property could be used to raise nominal prices even in the absence of the devaluation or monetary expansion effects. Indeed, he explicitly doubted that a monetary expansion with an unchanged price of gold could have much impact on the price level (Warren & Pearson, 1935, p. 148). "The mere issuance of paper money or expansion of credit, so long as each dollar is kept at par (with gold), will have very little influence on prices" (Warren to Roosevelt, April 24, 1933, in Nixon, 1969, p. 69).

As an agricultural economist concerned especially about the increase in real farm debt that the deflation of the Depression had created, Warren had a special interest in raising farm prices relative to other prices. The numeraire approach, on its face, would not seem to accomplish that end because presumably all prices should rise by the same percentage amount in dollars if the numeraire price were changed. But Warren divided prices into "slow-moving charges" and "fast-moving commodity prices" (Warren & Pearson, 1935, p. 195). The slow-moving charges—including wages—were sticky downward so that the Depression had resulted in a price ratio of fast-to-slow that was "abnormal." Raising the gold price would presumably right the imbalance. (In contrast, Fisher's notion of having a stabilized currency in terms of purchasing power involved targeting a broad price index rather than one based on a limited number of farm commodities.)

Warren's division of prices into slow- and fast-moving underlines a theoretical inconsistency in his approach to price setting. *If gold were the true numeraire—and if price setters really "thought" in gold—then sticky prices should be sticky in gold, not in the nominal currency unit.* By setting the stickiness in dollars rather than gold, Warren was implicitly contradicting the key role—as he saw it—of gold as the numeraire. The monetary unit could not be a mere veil for gold if a significant subset of prices were sticky in dollars. Fisherian "money illusion"—which is what Warren's sticky prices amount to—is based on the notion that the currency unit—not gold—is the key standard of value (Mitchell, 1993; Fisher, 1928).

In general, what one finds in Warren is a melange of theories in vogue at the time so that it is difficult to specify exactly how his gold/prices "model" worked. Indeed, the concept of a model specifying various relationships, particularly in the macro arena, was in an embryonic state at the time. Warren can at most be criticized for being no more precise than other economists of that era. Economic reasoning in the 1930s tended to be bivariate and uni-causal. The modern reader would find that Warren understates the role that the real side of the economy plays in prices, understates the effect of monetary policy independent from gold, and understates the effect gold prices have through devaluation against other countries on the gold standard. Yet the word must be "understate" because Warren gave some weight to all of these factors. But—absent a rigorous model—the amount of weight he gave is hard to quantify.

Warren (and Pearson) produced innumerable charts and tables, some purportedly going back to ancient times, presenting an air of scholarship and expertise that undoubtedly was very impressive to Roosevelt. Moreover, Warren had a definite plan and belief. And his belief tied neatly into the inflationist elements within the Democratic Party that had remained active since the days of William Jennings Bryan. Finally, Warren had another connection

with the Roosevelt administration; Henry Morgenthau, Jr., Roosevelt's Secretary of the Treasury, had been a student of Warren's at Cornell.

By way of contrast, Roosevelt was receiving contradictory and confusing advice from all quarters—academic, business, financial, and political. There were “sound money” men who thought the gold price was untouchable and who fretted about inflation at the bottom of an incredible Depression. For some of these advisors, maintaining the gold price was a matter of morality. In part the morality issue related to “gold clauses” that were inserted in many commercial and financial agreements specifying payment in gold equivalents. These clauses had developed in the aftermath of the Civil War departure from gold and the inflation of that earlier era (Friedman & Schwartz, 1963, p. 71). Ignoring the sound money school, Roosevelt followed Warren's prescription. He severed the dollar from gold, thus ending the effort to maintain the price at \$20.67 per ounce. And he used various means to bid up the gold price.

But by late 1933 he was being warned that his ad hoc gold policy was creating market uncertainties. John Maynard Keynes published an open letter to Roosevelt at the end of the year (Keynes, 1933). Shortly before the letter was published, he passed the contents along to the president through Felix Frankfurter, a Harvard professor and New Deal advisor (and later a Supreme Court Justice) (Schlesinger, 1960, pp. 404–406). Keynes made three points.

First, he was critical of the notion of raising prices as an end in itself, although acknowledging that price increases would help debtors. Keynes argued that expanding aggregate demand through government deficit spending would stimulate real output and—as a byproduct—raise prices. Price increases were thus to be viewed as mere symptoms of recovery. But absent a demand expansion, pushing up prices through supply-side measures such as NIRA codes or limits on agricultural production would impede recovery. Second, a Fisher-type monetary expansion would not by itself stimulate the economy; such an expansion was necessary but only to accommodate the added demand that deficit spending would bring (see Sumner, 1999). Third, Roosevelt's *ad hoc* policy of bidding up the gold price without an announced objective—“a gold standard on the booze”—was causing unhelpful speculation and was bad for business confidence. True, gold price increases would raise prices of tradable goods through the devaluation effect. But it was foolish to believe that apart from that effect, there was some “mathematical relation” between gold and prices. Essentially, Keynes' letter was a slam at relying on monetarism, whether that of Irving Fisher or of the free-silver forces in Congress. And it was also a slam at Warren's gold policy.

Although unhappy with the president's approach to gold, Keynes agreed with Roosevelt's view that maintaining a traditional gold standard was not the right objective of economic policy. “The currency and exchange policy of a country,” Keynes said, “should be entirely subservient to the aim of raising output and employment.” Thus, he did not recommend setting a new gold price fixed for all time. The ideal policy would be for the major countries to agree on “exchange stabilization.” But Keynes did not think such an international agreement was feasible as of late 1933. As a second best, therefore, Roosevelt should set an official gold price—not forever—but for the time being, thus ending uncertainty and speculation. With that done, the president could turn his attention to appropriate stimulatory fiscal policy and end the excessive focus of his administration on gold and prices.

It is not clear that Keynes' advice had a direct influence on Roosevelt. There had been discussion in the White House before his letter that the gold price issue was causing

uncertainty and needed to be resolved (FDR library, OF 21, box 1 [Bruère memo]). Roosevelt met with Keynes 5 months after the letter appeared but gave conflicting accounts of his impressions of that meeting (Schlesinger, 1960, pp. 404–406). Nonetheless, a new gold price was officially re-established by Roosevelt on January 31, 1934 at \$35 per ounce under the enabling statute—the Gold Reserve Act of 1934. This price increase was rather arbitrary and was essentially decided by the president. Indeed, the draft of the public announcement shows blanks where the gold price appeared in the final version—apparently filled in as \$35 in Roosevelt’s hand (FDR library OF 229, box 1; Morgenthau diary, reel 1, book 1). The new gold price was not necessarily intended to be permanently fixed; the statute permitted changes based on the president’s judgment concerning economic conditions—a feature in line with Keynes’ advice.

There were some technical issues regarding Federal Reserve regulations entailed in the president’s action. But these were worked out with the Fed (FDR library, OF 90, box 1). However, the president was soon challenged in court. At issue were the Act’s provisions that voided gold clauses in private and official contracts and forbid private gold holdings. For example, one suit demanded redemption of a \$20 gold certificate in gold. Eventually, the Act was tested before the U.S. Supreme Court. On behalf of the New Deal administration, the attorney general argued that “gold is not an ordinary commodity. It is a thing apart, and upon it rests, under our form of civilization, the whole structure of our finance and the welfare of our people. Gold is affected with a public interest. These gold contracts, therefore deal with the very essence of sovereignty, for they require that the Government must surrender that sovereignty” (FDR library, OF 229, box 7). By a narrow 5–4 decision, the Court upheld the president’s action.

Some key figures of the era heralded the Court’s decision. Financier Bernard Baruch wired Roosevelt’s assistant that “the President has won a sweeping victory. Please tell him this delights me more than I can express. It will serve notice upon those that had their doubts and fears and will make his critics and enemies respect his judgment and courage. Because of the removal of this uncertainty I expect to see business resume its advance. I join you in the happiness which you must all feel.” Similar sentiments were expressed by James Rand, president of Remington Rand, who headed a business and agricultural group—the Committee for the Nation—that supported the gold price hike on Warren-type grounds (FDR library, OF 229, box 7). Irving Fisher and Warren wanted a still-higher gold price (FDR library, OF 229, box 4; Morgenthau diary, reel 1, book 1). But many disapproved of the president’s action and made their objections known publicly, including former president Herbert Hoover.

Roosevelt had the precedent of the British abandonment of the gold standard in 1931 on his side. Not only had Britain abandoned gold, its action had triggered speculation at the time that the U.S. would soon do so. As a result, gold flowed out of the U.S., arguably impeding the Federal Reserve from pursuing an antidepression monetary policy (Wheelock, 1998, pp. 135–140). Roosevelt might have reasoned that setting a new, higher gold price would cause a reverse flow of gold into the U.S. (which it did), perhaps stimulating monetary expansion. In any event, he cited “the adverse effect of depreciated foreign currencies” (which certainly included the British pound) in his proclamation.

Had the Supreme Court ruled against Roosevelt, rumors in the press had it that he would

have disobeyed the Court, provoking a constitutional crisis. There was said to be a contingent speech prepared announcing the president's refusal to obey in the event of an adverse Court decision. Roosevelt himself cited from a contingent speech in a letter to Joseph P. Kennedy although the specific citation does not deal with disobedience *per se*. It did express a personal, if not legal, contempt for the conservative Court (FDR library, OF 90, box 1).

Warren's influence on Roosevelt was sufficiently great that senators debating the Gold Reserve Act of 1934 seemed dubious about Warren's denial that he had written the bill (U.S. Congress, 1934a, pp. 262–263). If it is remarkable that Warren had the influence he did on Roosevelt, it is no less remarkable that there were major figures content to wallow in depression in pursuit of the morality of sound money—especially after money had become so unexpectedly more sound due to massive deflation. Some commentators have expressed skepticism that Roosevelt actually believed in Warren's theory. "What carried the day with Roosevelt," Arthur Schlesinger wrote, "was not the conviction that the Warren theory was right so much as the fact that Warren offered a program of action when the demand for action seemed irresistible." At one point Roosevelt defended his gold policy to administration officials as necessary to avoid "an agrarian revolution" (Schlesinger, 1958, pp. 240, 242). When an academic advisor submitted his resignation in protest of the president's gold policy, Roosevelt denounced him for "do-nothing advice" and for placing "a former artificial gold standard among nations above human suffering and the crying needs of your own country" (Roosevelt to O.M.W. Sprague, November 22, 1933, in Nixon, 1969, pp. 496–497).

Much of the early gold-related tension among Roosevelt's economic advisors was brought to a head by the London Economic Conference that began in June 1933. This conference, originally planned under the Hoover administration, had been viewed by President Hoover as a way of coaxing countries that had abandoned the gold standard back on to it. But under Roosevelt the conference was the scene of internecine battles over monetary and other issues among various presidential advisors—although Roosevelt had made it clear before the conference that the gold standard was to be abandoned.

In preconference planning, the U.S. seemed to favor maintaining some type of stability between the French franc, the British pound, and the U.S. dollar—with some use of gold. At a press conference, the president speculated about an "imaginary coin. . . fixed in terms of gold or gold and silver" in which international contracts might be drawn up but against which other currencies would fluctuate. Generally, the U.S. position seemed to center on vague notions of central bank cooperation combined with more international monetary discretion (FDR library, OF 17, Warburg memo). However, eventually the conference ended in acrimony after publication of a statement by Roosevelt denouncing "old fetishes of so-called international bankers" and indicating that freer trade and dealing with "fundamental economic ills" was the proper goal of the conference (Schlesinger, 1958, pp. 200–232; press conference of June 7, 1933 and radiogram of Roosevelt of July 2, 1933 in Nixon, 1969, pp. 207–210, 268–270).

Given the earlier history of silver agitation, it is not surprising that the ideas of the free silver movement of the 1890s still echoed through Congress as the New Deal administration first took office. Numerous bills were submitted to Congress relating to silver. Demagogic priest Father Charles Coughlin, whose radio broadcasts were increasingly influential, became shriller and shriller in denouncing the gold standard and pushing for silver. Various members

of the Senate and House pushed (unsuccessfully) for Roosevelt to send Coughlin to the London conference (Nixon, 1969, pp. 221, 225–226). At the time, Coughlin supported Roosevelt, praising him in religious terms reminiscent of Williams Jennings Bryan's cross of gold allusion. "For more than two and one-half years Christ attempted to convert the money-changers of Jerusalem. But eventually he was forced to drive them from the Temple after having upset their tables. I am confident that this very day Mr. Roosevelt is prepared to do likewise. The international bankers are on their way out" (Coughlin, 1933, p. 37). And testifying before Congress in favor of the administration's Gold Reserve Act of 1934, Coughlin declared that "I know if we patiently and intelligently follow Mr. Roosevelt he is not going to make a mistake, because God Almighty is directing him" (U.S. Congress, 1934b, p. 69).

And, indeed, the historical/religious links to Bryan were evident. Bryan's former congressional assistant, Edgar Howard, by then a member of congress himself, said that "the heavy cross of gold has been lifted from the backs of American citizens" by Roosevelt's action (Cherny, 1994, pp. 184–185). If that were not tribute enough to Bryan, in 1934, Congress passed the Silver Purchase Act mandating large purchases of silver at high prices. But silver played only a minor role in the monetary system thereafter. The Act mainly produced a large silver hoard at the Treasury and a substantial subsidy to silver mining interests until the silver policy was officially ended in the early 1960s. In contrast, Roosevelt's gold policy in the form of the \$35 per ounce price became enshrined in the later Bretton Woods agreement of 1944 and eventually became a major component of the collapse of that agreement in 1971.

There remains the issue of what impact the gold revaluation actually had on U.S. price levels. Warren's colleagues, in their tribute to him, make much of the fact that an index of crop prices generally rose by about the same percentage as the gold price from early 1933 to early 1934 (when the \$35 per ounce price was established). But their chart shows crop prices started to rise before gold prices were allowed to fluctuate, rising much faster than gold for several months, falling back and then rising again (Pearson, Myers, & Gans, 1957). They give no credit for the farm price rise to the partial recovery of the overall economy. Nor do they credit the New Deal's various agricultural price support programs, notably the Agricultural Adjustment Act of 1933, that limited acreage and constrained supply at a time of rising demand. In wheat, for example, the U.S. coordinated domestic output reductions with an international agreement among major wheat producers to limit world supply (Johnson, 1934). The restoration of confidence in the banking system, including an initial program of deposit insurance, occurred simultaneously with the upward push on the gold price (Friedman & Schwartz, 1963, pp. 434–442). If panic and a worsening Depression had brought commodity prices down, surely an end to the panic and an economic expansion would be expected to raise them.

During 1933, gold had become yet another commodity whose price the government was trying to raise, albeit one with monetary significance. That its price rose during that period at about the same rate as the prices of selected other commodities that were targeted should be no surprise. The value of the dollar relative to other currencies and the impact that world market prices may have had is similarly neglected by Warren's colleagues in their paean to him. However, the drop in the value of the U.S. dollar relative to other major currencies

during the gold price episode was quite dramatic. From March 1933 to March 1934, the British pound rose 48% relative to the dollar. The dollar price of the Italian lire, German mark, and Dutch florin rose by two-thirds. And the Japanese yen rose by 41%. Mexico remained tied to the U.S. dollar but the Canadian dollar rose against its American counterpart by 20%.

As contemporary critics noted, the price index that Warren (and Pearson) used to show the correlation of commodity prices with gold was weighted towards international commodities; prices of other commodities (which they omitted) did not rise as fast. (Hardy, 1935, pp. 32–33) Moreover, the behavior of particular international commodity prices needs to be considered in evaluating the simple devaluation effect. Coffee prices are an example. Brazil's currency appreciated only 12% relative to the dollar from March 1933 to March 1934. During that period, coffee prices rose by about a third, substantially less than the gold price increase. Thereafter, coffee prices fell, and by the end of the year coffee prices (relative to March 1933) had risen by an amount even closer to the modest Brazilian appreciation. Of course, the U.S. had no farm programs designed to raise coffee prices because little coffee is grown in the U.S. Without the effect of sizable dollar devaluation, and without targeted U.S. agricultural policies aimed at pushing up the price, coffee prices rose much less than other commodities that were so targeted.

Overall consumer prices as measured by the National Industrial Conference Board rose by just under 9% during March 1933—March 1934. Devaluation of the dollar produced a considerable gold inflow to the U.S. that lasted through the rest of the decade, suggesting dollar undervaluation. But there was no automatic expansion of the money supply as required under the rules of the game of a classical gold standard. Various devices were used to sterilize the gold inflow (Paris, 1938, pp. 107–108).

Thus, the sad aspect of the Roosevelt gold episode was that after staking out monetary sovereignty for the U.S., the New Deal did not undertake sufficient monetary stimulus. After 1934, Roosevelt lost interest in gold and monetary affairs, leaving such matters to the inflation-fearing Federal Reserve. Those academics concerned about monetary matters became preoccupied with schemes such as “100% money” (Phillips, 1995). The policy void was filled only by calls for monetary stimulus from the silverites, marginal social movements of the era, and the increasingly disreputable Father Coughlin. Coughlin lamented that Roosevelt had not—after all—chased the money changers from the temple. Instead, he said, the New Deal had “entrenched (the) power and increased profits of the international manipulators” (Coughlin, 1936, p. 179). He teamed up with other populist radicals in an abortive third-party campaign to unseat Roosevelt in the 1936 elections and was later taken off the air by the Church as his broadcasts became increasingly anti-Semitic (Kazin, 1995, pp. 116–133; Bennett, 1969; Brinkley, 1982).

If anything, the 1933 through 1934 increase in the price of gold was a notable experiment in the social sciences, something usually difficult to perform in macroeconomics. The episode showed that although currencies such as the dollar had been “backed” by gold, people no longer “thought” in gold-denominated prices. Fisher's money illusion meant that the true numeraire for most prices—those not set in world markets—was the dollar, not gold. Indeed, ultimately it is some version of Fisher's money illusion, that is, a stickiness of domestic prices and wages in nominal terms, that allows devaluations to have real effects.

Perhaps the best indication of the problem of attributing great potency to gold as numeraire came in the recession-within-the-depression of 1937–38. The Warren explanation for the fall in commodity prices in the early 1930s hinged in part on an increased demand for gold triggered by the British abandonment of the gold standard in 1931. Speculators believed the dollar would be next, and so shifted to gold at the official \$20.67 price then prevailing. The result was gold exports from the U.S. But in 1937–38, with the gold price fixed at \$35 per ounce, gold continued to flow *into* the U.S. The Warren prediction should have been a *rise* in commodity prices due to a gold “surplus.” Gold was being exchanged for dollars because world demand was shifting toward the dollar and out of gold. Yet prices *fell* in 1937–38, just as they had in the early 1930s, in seeming contravention of the Warren “theory.” Price movements in 1937–38 suggest that apart from dollar devaluation and farm programs, the business cycle (i.e., sensitivity of U.S. commodity prices to real economic activity) pushed up prices during the 1933–34 gold episode. Similarly, the business cycle pushed them down in the later economic decline.

The Roosevelt episode also demonstrated the American domestic focus in matters that might otherwise seem to be international from the viewpoint of foreign observers. Roosevelt would not let international monetary considerations trump U.S. internal economic policy needs, however poorly those domestic needs were understood. On the other hand, when it came to trade, Roosevelt was committed to lowering the (Republican) Smoot–Hawley tariff of 1930 because he thought doing so would stimulate the American economy. Roosevelt had been elected to do something about the Great Depression *in the U.S.A.* If that meant abandoning international gold standard commitments, so be it. On that score, William Jennings Bryan would have been proud. But that Roosevelt—having established independence—did not follow up in 1934 and thereafter with an aggressive monetary stimulus would surely have been a disappointment to Bryan.

4. Episode III. Polishing the cross of gold: 1944

... (T)he whole thing is nothing less than a plot to give Great Britain control of our gold stock and unload upon the United States an immense volume of debts owed by Britain to other countries.

Congressman Frederick C. Smith commenting on an early version of a plan for the IMF
(Van Dormael, 1978, p. 111)

Only one episode in this saga of American insistence on domestic monetary sovereignty took place against a background of (wartime) prosperity: the Bretton Woods agreement of 1944. However, the legacy of William Jennings Bryan remained strong and influenced the outcome even then. Although the general spirit of the times was to create international institutions such as the United Nations to ensure against yet another world war, the U.S. was not about to surrender its monetary sovereignty. Public suspicion of international financial conspiracies (particularly British) remained strong. And a belief was widespread that the U.S. could easily tumble back into depression once wartime demand pressure ceased. No president or congress would have consented to turning monetary sovereignty over to some

external institution because such sovereignty might be needed should a postwar domestic downturn of the economy develop. A weak International Monetary Fund was the result.

When options for international monetary policy are considered in debates today, the basic choice is always between floating and fixed exchange rates (in their various forms). That was not the case in 1944, however. Floating rates were associated with breakdowns of the world economic order, that is, depressions and wars. Thus, the issue—as the delegates at Bretton Woods saw it—was *what kind* of fixed exchange rate system was to be created, not *whether* some version of fixed exchange rates should be adopted.

And the choices were constrained. Thanks to the devaluation of the dollar during 1933 through 1934 and a wave of flight capital from Europe as World War II neared, there had been a “golden avalanche” into the U.S. In 1932, the U.S. had about 36% of the world’s monetary gold. By 1938, the proportion was 57% and in 1947, 71% (Triffin, 1960, pp. 72–73). With so much of the world’s monetary gold in official U.S. hands, returning to a classical gold standard was not feasible, even apart from U.S. concerns about monetary sovereignty. A classical gold standard requires that all participants—not just one—have substantial gold reserves to back their currencies.

The Bretton Woods system seemed to stem initially from an attempt to counter Nazi propaganda early in World War II about a “New Order” of currency exchange. It also arose from negotiations between the U.S. and the British about the terms of the Lend–Lease plan, the program by which Britain received military supplies before the formal entry of the U.S. into the war. British thinking, guided by John Maynard Keynes, evolved toward a world central bank or “clearing union” that could essentially issue a form of currency called “bancor.” The new currency would be created as an overdraft credit whose value would be defined in gold terms. Countries with significant surpluses or deficits would be penalized. Under certain circumstances, countries could be required by the new bank to appreciate or depreciate their currencies (Van Dormael, 1978, pp. 1–39).

Far less well known than Keynes at the time was U.S. Department of Treasury official Harry Dexter White, a former academic who was influential with Treasury Secretary Morgenthau. His alternative plan—whose genesis may have reached back even before the attack on Pearl Harbor—was a more modest fund, more a constrained financial intermediary than a central bank. Treasury Secretary Morgenthau was initially interested in exploring the option of creating a world currency, but White persuaded him that such a radical step was undesirable. White’s plan in early versions would have created a gold-defined unit of account—called “unitas.” But unlike Keynes’ bancor, unitas would not be a currency (Mikesell, 1994, pp. 2–13). White’s proposal—as the Americans saw it—focused more “discipline” on countries running balance of payments deficits than did the Keynes plan (Black, 1991, pp. 37–38).

The White fund as it evolved could take resources obtained from depositing countries and lend to others. But it could not create money. Its internal governance would ensure the U.S. a substantial role in decision making. The dollar would play the role of a key currency. And given the large size of the U.S. gold stock, the dollar would be exchangeable for gold at Roosevelt’s \$35 per ounce price. White viewed gold as nothing special—just another commodity—but concluded that financial tradition required its continued use (Van Dormael, 1978, pp. 45–47). Indeed, in the view of key Treasury officials the gold standard had been

a major cause of the Great Depression and there was no desire to repeat that experience (Black, 1991, pp. 98–100). World cooperation through the IMF concerning exchange rates rather than any type of gold-based discipline was seen as the key to postwar economic success.

Attempts by Keynes to elevate White's unitas into a bancor-type world currency were rejected by the U.S. (Mikesell, 1994, p. 25). Eventually even the unitas as an accounting unit was dropped from the plan. Word of the discussions between the U.S. and Britain had leaked out by 1943. The Keynes plan was deemed unacceptable by many elements of the American financial community. A *Wall Street Journal* editorial declared that Keynes' "proposed bank would possess powers to control the world over. . ." (quoted in Van Dormael, 1978, p. 93). If anything, the U.S. financial community preferred a return to the gold standard. Given wartime prosperity, silverites and other such groups were no longer prominent in opposing gold. However, traditional American suspicion of international banking conspiracies and of British finance tended to unite Wall Street and Main Street in opposition to anything so bold as the Keynes plan. The White plan in contrast was intended to assuage such sentiments by making the proposal as unthreatening as possible. It also suggested, somewhat disingenuously, that postwar aid to war-ravaged Europe would be handled by external institutions (the World Bank and the IMF), not by new loans and grants from the U.S.

Obtaining Congressional assent to the Bretton Woods plan—even with its weak IMF—became a major challenge in both public and Congressional relations. And White was not always the diplomat he should have been in dealing with Congress (Black, 1991, p. 49). The Roosevelt administration carefully monitored press reaction to the proposals (FDR library, OF 229, box 8). Symbolic gestures, such as putting the IMF headquarters in the U.S. rather than London, became important (Van Dormael, 1978, pp. 206–207). Placing it in Washington, rather than New York, further suggested that the IMF would be subservient to American political rather than financial interests. Thus, in many respects the spirit of Williams Jennings Bryan hung over Bretton Woods. Any international institution that appeared able to limit American domestic economic policy was simply unacceptable.

In the end, Congress approved the legislation enabling U.S. participation in the Bretton Woods plan. Passage has been credited to a combination of Democratic "party loyalty" and appeals to the notion that passing the bill would help ensure future world peace (Mikesell, 1994, p. 44). The IMF was ultimately acceptable to Congress because it was not a central bank, because the American dollar was to be the key currency, and because the U.S. was to have the largest IMF quota. The largest quota in turn meant that the U.S. would have the most votes of any country in IMF deliberations. Maintaining the gold parity at \$35 per ounce was acceptable because the U.S. had more than enough gold to do so for the foreseeable future. White made proposals to enhance the authority of the IMF on Keynesian lines *after* Congress acted but these were not adopted (Boughton, 1998, p. 41).

5. Episode IV. Abandoning the cross of gold: 1971

In recent weeks, the speculators have been waging an all-out war on the American dollar. The strength of a nation's currency is based on the strength of that nation's economy, and the American economy is by far the strongest in the world. Accordingly, I have directed

the Secretary of the Treasury to defend the dollar against the speculators. I directed Secretary Connally to suspend temporarily the convertibility of the dollar into gold. . . Now this will not win us any friends among the international money traders. But our primary concern is with the American workers, and with their competition abroad.

President Richard Nixon, TV speech of August 15, 1971
(New York Times, August 16, 1971, p. 14)

Well into the 1950s, the U.S. could operate under the Bretton Woods framework without much constraint. At the established initial exchange rate parities, there was a “dollar shortage” that many believed was somehow permanent. Indeed, the explanations concerning the chronic American export surplus then were similar to what commentators today often say about Japan and its seemingly inherent trade surplus (Kindleberger, 1950). And as is typical of fixed rate regimes, the pressure to abide by the rules of the game under Bretton Woods was asymmetrical. Countries whose currencies were in excess demand did not have to follow the rule requiring monetary expansion and stimulus. Those nations whose currencies were in excess supply, however, had either to run down reserves or incur increasing liabilities if they failed to follow austerity policies. During the Korean War, of course, the U.S. economy had plenty of internal stimulus. But the post-Korean War U.S. economy was soft and featured recessions in 1953 through 1954, 1957 through 1958, and—much to the regret of then-presidential candidate Richard Nixon—in 1960 through 1961.

Nixon’s very narrow loss to John F. Kennedy in 1960 against the background of recession was something he would not forget when he eventually became president in 1969 (Gowa, 1983, p. 68). Meanwhile, Kennedy—who had campaigned on a platform of getting the economy moving again and who was surrounded by Keynesian advisors—faced a dilemma on taking office. The dollar shortage had shifted to dollar surplus, putting downward pressure on the dollar exchange rate that—under Bretton Woods—had to be resisted. At the same time, the U.S. gold stock was dwindling, raising the ratio of potential international dollar claims to American gold reserves. The rules of the game called for American policy austerity, not something compatible with Kennedy administration—or (later) Johnson administration—goals.

Moreover, as Robert Triffin warned, if the U.S. did succeed in reducing its balance of payments deficit, world reserves would not keep pace with the growth of trade and investment. The result, as he saw it, would be an international liquidity crisis. On the other hand, if dollars kept flowing abroad, the ability of the U.S. to maintain gold at \$35 per ounce would be increasingly questioned by speculators. As a solution, Triffin proposed turning the IMF into a true central bank capable of issuing a reserve medium that could take the place of gold and dollars. But his notion, a variant on the Keynes plan rejected by the U.S. at Bretton Woods, remained unacceptable to the U.S. A world central bank and a world reserve medium would constrain American monetary sovereignty. Perhaps in tacit recognition of this fact, Triffin focused on an intermediate goal that in hindsight seems very prescient: a monetary and ultimately currency union within Europe (Triffin, 1960, pp. 102–120, 141–144, 151–157).

Because a major reformulation of the international monetary system was not part of the American agenda, a variety of ad hoc policies were implemented under Presidents Kennedy

and Johnson. These policies were attempts to make domestic expansion compatible with maintaining the dollar exchange rate against foreign currencies. They included attempting to change the yield spread between long and short interest rates (“operation twist”), an interest equalization tax on foreign borrowing in the U.S. market, voluntary—and later mandatory—capital controls, and other measures. However, such policy instruments ultimately could not cope with the pressures created by the dramatic expansion of the American economy in the second half of the 1960s under the pressure of the Vietnam War. At its peak, the boom brought the U.S. unemployment rate down to 3½%, a level not seen since the Korean War.

By early 1968, there was intense speculation that the U.S. would not hold the gold price at \$35 per ounce. In March 1968, a hasty agreement separated the gold regime into two markets. There would be a private market, in which the gold price would clear at whatever level was determined by supply and demand, and an official market in which gold would be exchanged by central banks at the old \$35 Roosevelt/Bretton Woods price. Whatever reluctance foreign central banks had concerning this arrangement was overcome through a threat by the Fed to close the gold window entirely if they did not go along (Gowa, 1983, p. 53).

Once the two-tier gold system was put in place, the way was clear for gold “to go the way of wampum, clam shells, copper and silver, and to become a commodity” as Charles P. Kindleberger put it shortly thereafter (statement in U.S. Congress, 1970, p. 17). Despite this colorful phraseology, the two-tier system was not seen as a precursor to the end of Bretton Woods as a whole because there was no reason a fixed exchange rate system needed gold to operate. Special Drawing Rights (SDRs), new monetary units created by the IMF and first distributed in 1970, were thought to be an eventual substitute for gold as a reserve. As far as the two-tier system itself, it appeared to be a great success; a report by the Joint Economic Committee of Congress found no reason to raise the official price of gold. Instead, the report suggested that the IMF should formally modify its procedures to accommodate the two-tier system. (U.S. Congress, 1969) The two-tier approach had ostensibly fixed the immediate gold problem and would, it was thought, allow international reformers a chance to update the 1944 model in an orderly and deliberative way.

The problem was that although there was discussion within the Nixon administration about the dollar/gold problem—and, notably, a report by a task force headed by Treasury official Paul Volcker on the subject—there was not enough pressure to do anything about it absent a crisis (Nixon archives, Council of Economic Advisors collection, Volcker report, box 15; Gowa, 1983, pp. 129–130). The ad hoc measures taken during the Kennedy/Johnson period were viewed as undesirable by the report’s authors (Nixon archives, McCracken collection, boxes 87, 106). But so, too, was allowing external monetary considerations to impede domestic or foreign policy objectives. The Volcker report emphasized the SDR as a possible intermediate solution to the need for world reserves. In the long term, however, there should be a “fundamental, but evolutionary, change in the existing system.” Eventually, countries might put their official dollar balances, SDRs, and gold reserves into a “reserve settlement account” at the IMF (just as they had once put dollars and gold into the IMF to establish their quotas).

These new accounts would “consolidate the different types of assets. . . in one more or less homogeneous asset, thus adding to the stability of the system and further circumscribing the

role of gold.” Such ideas had been circulating since the mid-1960s (Black, 1991, pp. 83–84). Exchange rates would be realigned to give the U.S. increased competitiveness. The U.S. would somehow solve its inflation problems. When all of these goals were accomplished, the U.S. would have “restore(d) a considerable flexibility for domestic economic policy and for meeting. . . shifting security requirements.” Controls on capital movements would then be unnecessary.

However, the Volcker report indicated that if a crisis arose before such fundamental changes could resolve the gold/dollar problem, the U.S. might be forced to suspend gold convertibility or raise the price of gold. Trying to negotiate a solution retaining convertibility could be difficult given European—especially French—attitudes. Raising the gold price was seen as undesirable because it would just postpone any progress to fundamental reform. In time there would arise a new gold/dollar problem at the higher gold price. A small hike in the gold price would amount to a devaluation of the dollar (assuming other countries agreed) and soon the Triffin-type problems of the 1960s would recur. World gold reserves would become inadequate and there would again be the instability inherent in a system of two reserve mediums. A large increase in the gold price would “flood the world with liquidity” and thus contribute to inflation.

The Volcker report—in short—depicted two paths toward a change in the world monetary order. Both would downgrade the role of gold. The preferred option would be orderly planning for monetary reform in which the IMF would be modified through creation of the new reserve settlement accounts. But if time ran out before such an option could be negotiated, the U.S. would end gold convertibility rather than give gold a new injection of life through an official price hike.

Various advantages of ending gold convertibility were described in the Volcker report, although it argued that the U.S. would need the cover of a crisis to take such action. There would be no more runs on the American gold stock by foreign central banks, absent convertibility. And surplus countries would be left with two choices. They could passively accumulate more and more unwanted dollar reserves. Or they could revalue their exchange rates sufficiently to eliminate the surpluses.

In theory, the two-tier gold arrangements allowed time for orderly planning toward a solution along the lines envisioned in the Volcker report. But there was no orderly planning once the two-tier system was in place under either Johnson or Nixon. Conflicting positions within the federal bureaucracy produced a stalemate. As one observer characterized it: “. . . (T)he Treasury (was) staid and mired in detail; the Council of Economic Advisors (was) excessively abstract and intellectual; the Federal Reserve (was) overly preoccupied with price stability; and the Department of State (was) simply ineffective” (Gowa, 1983, p. 106, footnote 29). Whenever the issue came down to domestic considerations versus Bretton Woods obligations, the president made clear his priorities. He cautioned an incoming member of the Council of Economic Advisors about the need to keep the unemployment rate low in 1969 (Stein, 1994, p. 135). “I hear all about the balance of payments and nobody worries about 8% unemployment,” President Nixon said angrily at a 1970 meeting in his office (Gowa, 1983, p. 135, footnote 16).

Domestic developments soon forced a decision. Responding to inflation concerns in 1969, the Fed attempted to cool the overheated U.S. economy just enough to engender an

oft-sought, but difficult-to-achieve, soft landing. However, an outright recession developed and by 1970 through 1971, monetary policy had shifted toward stimulus. Low interest rates produced a short-term capital outflow, swelling unwanted dollar reserves at foreign central banks. The net export balance went into deficit. By the spring of 1971, central banks were rebelling against American pressure that they hold more dollars and that they refrain from converting dollars to gold (even though entitled under the two-tier system to do so). Pressures within the Federal Reserve to raise interest rates were resisted by Fed Chairman Arthur Burns. Burns explicitly cited the perverse raising of interest rates in 1931 by the Fed in response to the gold outflow of that era. The Fed, in his view, had choked off a potential recovery in 1931; he was not about to commit the same mistake four decades later (Wheelock, 1998, pp. 161–164).

Although the spring crisis was resolved, it was clear that a new one could easily arise. The chair of the Council of Economic Advisors requested a legal opinion from the Department of Justice as to whether the gold price could be increased from \$35 per ounce. He was told that such a price change could be made only with congressional approval, something unlikely to be obtained quickly in response to a crisis. Moreover, congressional action was itself constrained by U.S. obligations under Bretton Woods to maintain the \$35 price. On the other hand, he was also told that there was no legal bar to suspending gold convertibility (Nixon archives, Council of Economic Advisors collection, box 167).

The crisis that would force a decision came in August 1971. In early August, there were already pressures from Congress to close the gold window. The British sought guarantees from the U.S. about the value of their dollar reserves (Gowa, 1983, p. 149). Top officials in the Nixon administration were summoned to a hasty conference at Camp David and a new policy course was charted. Fed Chair Burns opposed abandoning gold but Treasury Secretary Connally convinced the president to do just that. After the conference, the president went on national television on August 15, 1971 to announce his decisions (Gowa, 1983, pp. 150–170; Stein, 1994, pp. 165–166).

As a speech, President Nixon's address was remarkable for what it was and what it was not. It was not especially well delivered, particularly at the outset. The speech lacked the gripping oratory of William Jennings Bryan with his invocation of a cross of gold. President Nixon fumbled with his notes, stumbled on his words, wiped his brow, and seemed nervous. He began with discussion of obscure tax legislation. But then he got to the heart of the matter and announced a wage-price freeze to be followed by controls, the closing of the gold window (and an end to Bretton Woods), and a 10% import surcharge (tariff).

The Nixon speech was surely the high point of post-World War II presidential economic decision making. Although the ghost of William Jennings Bryan had pushed Roosevelt to break from gold and ultimately raise its price, gold still retained a formal role in U.S. monetary affairs after 1934. That role was rejuvenated in 1944 under Bretton Woods at the \$35 Roosevelt price. It is often said that only Nixon, a Republican anticommunist, could open relations with mainland China. Similarly, only that same Republican president—a representative of the party of sound money in 1896—could finally and completely kill the gold standard in 1971. Even if Bryan were not impressed with Nixon's oratorical skills, he surely would have been cheered by the content of Nixon's speech.

In theory, 1971 could have been a turning point at which the IMF—after an exchange rate

realignment—was substantially strengthened along Keynes–Triffin lines and converted into a true central bank. However, there was no official U.S. interest in doing any such thing. Only one thing was made clear by the U.S.: gold would not play a significant role in whatever new arrangements might be formulated, especially if Treasury Secretary Connally had anything to do with it (Nixon archives, McCracken collection, box 10). The U.S. did agree to the Smithsonian accord of December 1971—a “Bretton Woods lite” arrangement with new fixed exchange rates and no real role for gold. With Smithsonian in place, the IMF and its key members seemed anxious to formulate more elaborate institutions. But official U.S. policy was one of benign neglect despite rhetoric about fundamental reform and despite some internal concerns about a lack of policy (Nixon archives, Stein collection, box 172). Eventually, a U.S. “plan” was formulated—mainly so that it could be said there was one. The plan was published to prove that it existed in the 1973 *Economic Report of the President* (U.S. President, 1973, pp. 160–174; Nixon archives, Stein collection, box 2). But no steps were taken to implement the plan.

It is clear that the U.S. did not want to return to any sort of gold regime. But why didn't the U.S. move toward a new set of international arrangements without gold, but with an enhanced IMF? What about the “fundamental, but evolutionary, changes” that the 1969 Volcker report had discussed? The answer seems clear. In 1971, the U.S. had—as in 1933—declared its monetary independence; it was not interested in designing new constraints on its own domestic policy (Nixon archives, Stein collection, box 1). Moreover, in a twist of fate related to President Nixon's earlier political career, the IMF may not have been President Nixon's favorite institution.

Harry Dexter White, the American who negotiated the Bretton Woods agreement, became a member of the board of directors of the IMF in 1948. But shortly thereafter, White was accused of being a Soviet agent. His case became intertwined with the Whittaker Chambers—Alger Hiss espionage investigation, a major event in Nixon's political rise. At a congressional hearing, White—after resigning abruptly from his IMF post—was grilled by then-Congressman Nixon. White denied the accusations against him and was never formally charged. He died of a heart attack just after the hearing. Thereafter, White's family continued his defense posthumously. But in 1953—when Nixon was vice president—White was declared to have been “a Russian spy” by U.S. Attorney General Herbert Brownell (Rees, 1953, pp. 11–16, 377–390, 406–426; White, 1956). Other Treasury and IMF officials linked to White were also accused and resigned. Some fled to Canada or China in the aftermath of the charges (Mikesell, 1994, pp. 55–57). Whether Nixon recalled this episode in 1971 through 1973 is unknown.

As noted, fixed exchange rates were temporarily resurrected by the Smithsonian agreement of late 1971, which established new parities (and a lower-valued dollar). However, the president remained focused on domestic matters even after the Smithsonian accord. In June 1972, when exchange rates were discussed at a meeting with White House Chief of Staff H.R. Haldeman, Nixon's attitude was forever immortalized on one of the Watergate tapes: “I don't give a (expletive deleted) about the lira” (quoted in Gowa, 1983, pp. 136–137, footnote 19). Not surprisingly, therefore, when the dollar came under pressure in early 1973, the Smithsonian accord was unilaterally terminated by the U.S. Since then, the international monetary “system” has been one in which countries do what they like or what they can. And

official gold reserves sit in vaults waiting for someone to figure out what should be done with them.

6. Episode V. Longing for the cross of gold: 1980 to 1982 and beyond

Certain ideas enraptured Kemp, regardless of voter reaction. Iowa politicians still shake their heads about his insistence in the '88 campaign on trying to convince the state's farmers that their economic troubles could be traced to President Franklin D. Roosevelt's decision to abandon the gold standard.

Newspaper profile of Jack Kemp, unsuccessful candidate for the Republican presidential nomination in 1988 and vice presidential candidate in 1996 (Shogan, 1999, p. A5)

The fact that Franklin Roosevelt and Richard Nixon both abandoned the gold standard during their administrations suggests a bipartisan tendency in the 20th century to favor domestic economic concerns over international “obligations.” William Jennings Bryan, it seems, ran for president in the wrong century. However, there remain those in American political circles that still long for gold, mainly in certain sectors of the Republican Party. Yet even the American “gold bugs” see the issue largely in a domestic context, that is, as a way of limiting the American government by instituting “a wholly ‘denationalized’ money whose supply and value are at long last free from the arbitrary manipulations of a nonmarket monopolist” (Salerno, 1982). The implications of such plans for international monetary affairs are not of major concern to these individuals.

In 1980, toward the end of the Carter administration, Republican Senator Jesse Helms managed to insert a provision in an IMF funding bill that required creation of a commission to study a return to the gold standard. Carter signed the bill but never appointed the commission. A deal had been cut with Congress that Carter would not do so unless he won the 1980 election. Thus, it was left to the Reagan administration to appoint the membership. In the background was double-digit inflation and rising unemployment—so-called “stagflation”—leading to complaints about monetary policy (Schwartz, 1982, pp. 538–540). And Reagan was believed to have a “sympathetic” attitude toward resumption of a gold standard (Stein, 1994, pp. 298, 302).

A 16-member commission was established chaired by Treasury Secretary Donald T. Regan. Included in the membership were three senators, four congressional representatives, two members of the President’s Council of Economic Advisors (along with a former member), three members of the Federal Reserve Board and four nongovernment representatives. The Gold Commission ultimately reported in March 1982, after what were apparently contentious deliberations. Its official report, with only 2 to 3 members formally submitting a full minority report, is peppered with dissents on various points. A sense of discord is evident from the introduction:

Though it became apparent to us during our deliberations that we would not be able to achieve a unanimous set of recommendations, on some issues, it was possible to form majorities. Even so, a majority vote in favor of a specific recommendation did not signify that all so voting had the same purposes and/or interpretations in mind. Moreover, if each of us had been reporting singly instead of as one of a body of colleagues, individual

members would not necessarily have expressed themselves in precisely the way the recommendations are stated. (U.S. Commission on the Role of Gold in the Domestic and International Monetary Systems, vol. I, 1982, p. 3).

Consistency was not always a virtue. Senator Roger Jepsen, a member of the commission, submitted reports to the Joint Economic Committee favorable to the gold standard along with a statement that he “favor(ed) the remonetization of gold” (U.S. Congress, 1981, p. v). Yet when the official report was issued, he did not join with the commission minority that favored a return to a gold standard. Still, it was difficult to determine who favored what in the “majority” report. In contrast, the minority report (described below) was clear about what it favored.

Some of the seeming support for gold in Congress from Republicans may have stemmed from the loose association of “supply-side economics”—which became associated with the Reagan tax cuts—and the gold standard. Arthur Laffer, whose namesake Laffer curve purported to show how tax cuts would generate increased federal revenue, was viewed as a supply-side guru at the time. And Laffer favored a version of the gold standard. The Laffer plan—submitted as a bill by the progenitor of the Gold Commission, Senator Jesse Helms—was a complicated scheme of gold reserves, formulas adjusting monetary policy to those reserves, and trigger points. Under the plan, the price of gold would change if reserves reached too-low or too-high levels, despite the formula (U.S. Congress, 1980, pp. 90–100).

Laffer attempted to tie his plan to proposals made in 1972 by Federal Reserve Chair Paul Volcker when Volcker served in the Nixon administration. It seems, however, that the Volcker proposals were not intended to impose strict limits on U.S. monetary policy, unlike the Laffer plan. They dealt with international reserves generally—not gold alone. Read in the context of the U.S. as a deficit country in the early 1970s, the Volcker proposals were designed to push the burden of adjustment equally to surplus countries such as Japan (Cooper, 1982, pp. 33–34; U.S. President, 1973, pp. 160–174). And as noted earlier, they seemed designed more to prove that the U.S. had a world monetary policy than as a plan to be seriously pursued.

The minority Gold Commission report ran about 300 pages, substantially longer than the “majority” report (U.S. Commission, 1982, vol. II; Paul and Lehrman, 1982). Much of it consists of a monetary history of the U.S. going back to colonial times, debating such points as whether there really was a depression in the 1870s or 1890s and expressing indignation at Franklin Roosevelt’s gold policy. Under the heading of “The Moral Argument for Gold,” the minority declared that “gold is honest money because it is impossible for governments to create it” (U.S. Commission, 1982, vol. II, p. 248). Thus, the Federal Reserve and its paper money should be phased out. Something along the lines of the depression-era “100% money” plan should be implemented (U.S. Commission, 1982, pp. 262–263; Phillips, 1995). The complete package of reforms would take 3 years to accomplish and perhaps a 1-year recession would result. But “the following 10 years would be ones of prosperity, high real economic growth, and low levels of unemployment” (U.S. Commission, 1982, p. 27). Were the U.S. to do this, other countries would likely do the same, producing a world of fixed exchange rates and *laissez-faire* as a byproduct (U.S. Commission, 1982, p. 268).

In contrast to this gold-based nirvana, an impending economic apocalypse—absent such

reform—is suggested by the commission’s minority report through references to the rise of Hitler and Mao Tse Tung. But a strange glimmer of hope is held out: “With the collapse of the official money and the official economy, the underground economy might be able to shift to using silver and gold coins, and thus some ascending reforms might be possible” (U.S. Commission, 1982, p. 257). In short, the minority envisioned a very dark short-term cloud but with a possible long-term silver (and gold) lining.

Basically, the commission’s “majority” supported only the issuance of various decorative gold coins by the Treasury but not as legal tender. This proposal was actually viewed as a victory by the most ardent gold proponent on the commission, Rep. Ron Paul, later the Libertarian Party presidential candidate in 1988. In his view, having weight-standardized gold coins available as an alternative to official money would lead to the replacement of official paper money by market forces (Schwartz, 1982, pp. 545–546).

The commission majority opposed issuance of gold-backed money or bonds. It thought the Treasury and the Federal Reserve should study valuing U.S. gold reserves at the actual market price, although no clear reason why this mattered was articulated. And it rejected conducting open market operations in gold. In a final blow to the gold advocates, the commission took a traditional monetarist view, suggesting that the Fed should consider a rule requiring a steady growth of the money supply. The commission concluded that “under present circumstances, restoring a gold standard does not appear to be a fruitful method for dealing with the continuing problem of inflation” (U.S. Commission, 1982, p. 17).

Although much of the majority report focused on purely domestic implications of the gold standard, there was some recognition of the international implications:

Most of us believe that even if other countries with substantial gold stocks and the major gold-producing countries were to agree with us on a restoration of an international gold standard, the United States –and the system as a whole –would confront an as yet unsolved problem of the vast quantity of dollars world-wide with potential claims to gold convertibility. We are not in fact aware of international interest in restoring a gold standard. Indeed, a number of foreign officials have expressed negative views towards a gold standard. (U.S. Commission, 1982, p. 19).

Yet despite this international reference, the Gold Commission report was essentially inward looking, by now an American tradition whenever gold is discussed. The free silverites of the Bryan era wanted to end the gold standard to follow an aggressive inflationist domestic agenda. Roosevelt went off gold for domestic reasons, ignoring foreign concerns as expressed at the London Economic Conference. The IMF was made a weak institution at the behest of the U.S. that did not want a true international central bank that could exercise any constraint on U.S. domestic policy. Nixon acted unilaterally, closing the gold window and ending Bretton Woods, to pursue domestic objectives in an unfettered fashion. Even the monetarist members of the Gold Commission could not entertain gearing monetary policy to gold inflows and outflows. There was no guarantee that such flows would produce the kind of passive, constant money-supply growth advocated by academic monetarists such as Milton Friedman.

Of course, there is never a final word on the gold standard. When it was announced in 1999 that international economist Robert A. Mundell had won the Nobel prize for his work

on exchange rates and macroeconomic policy, there was a flurry of interest in gold in the press. Mundell was depicted as a gold standard advocate, albeit one whose views were out of the mainstream. In the early 1980s, when inflation and stagflation were perceived as the world's major problem, Mundell favored a return to gold (Mundell, 1982). However, whatever his views may have been in the past, by the late 1990s Mundell did not believe that the old gold standard would be resurrected. That is, he did not foresee an international monetary system in which all major currencies were pegged to gold. Rather he argued that central banks might come to use the market price of gold as an index of inflation expectations (Mundell, 1997).

Some in the Republican Party have kept faith with William McKinley's belief in sound money. But today, most economists think of the gold standard as just one form of a fixed exchange rate system. However, for a gold standard to be a fixed exchange rate system, at least two countries must participate. If only the U.S. were to return to gold, the dollar and gold would be tied to one another and would together float against other currencies. Advocates of a unilateral U.S. return to gold either believe that other countries would follow the U.S. lead—and there is no sign of any such thing—or they see some other virtue in gold. Perhaps like George Warren, they see a quasi-magical power in gold solely as a numeraire. Or like Arthur Laffer, they think that gold flows would be a useful guide to monetary policy.

7. Conclusions

The ultimate triumph of William Jennings Bryan's battle against gold could be seen 100 years after the defeat of his first campaign for the presidency. Whereas incumbent Bill Clinton spoke of a "bridge to the 21st century" in the 1996 presidential campaign, candidates such as Steve Forbes and Jack Kemp tried to interest the public in returning to the gold standard. But such a monetary bridge to the 19th century simply did not resonate with the electorate. It just sounded odd. A candidate might as well have campaigned for a return to the bustle and the buggy. By the 2000 campaign, Kemp had dropped out of presidential politics. And Steve Forbes' gold position had been condensed into single sentence in his campaign book, easily lost in a sea of other agenda items (Forbes, 1999, p. 177).

Radical monetary conspiracy types in the U.S. are now more likely to have a right/anarchist tilt in place of Bryan's left/statist leanings. Where once the alleged conspiracy was that the U.S. went *on* the gold standard, now the conspiracy is that the country was illegitimately taken *off* gold. From this belief, extremist groups sometimes justify actions such as passing bad checks—because official money isn't "real" anymore. That some of the wilder groups are found in states such as Idaho and Montana—the old silver producing areas that were once home to free-silver agitation—is surely no coincidence. Apart from its odd domestic legacy, Bryan's posthumous victory over gold has international monetary significance. It means that the U.S. will not support an IMF that resembles a true central bank, let alone some sort of international euro-type currency. Even the constrained SDR that the IMF was allowed to create remains a minor element in world reserves and no distribution of SDRs has occurred since 1981.

An international version of the euro administered by a true world central bank would end

domestic monetary sovereignty of the U.S. A strong IMF would infringe on that sovereignty. Such infringement is something an American president and congress today would be no more likely to accept today than they were in 1944 when Bretton Woods was negotiated. Of course, countries such as Argentina remain free to tie themselves to the dollar unilaterally if they wish to do so. One can even imagine the development of a future NAFTA monetary zone based on the U.S. dollar. But such a development could occur only if the partner countries agreed to accept a monetary policy “made in the U.S.A.” and based on American domestic considerations.

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