The United Kingdom and Italy between Bretton Woods and European Monetary Integration

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SUMMARY

This dissertation describes the formation of support for monetary integration among European countries in the period between 1968 and 1973, claiming that there was a clear connection between the demise of the Bretton Woods monetary system and the rise of support for a European solution to the subsequent monetary turmoil.

During the late 1960s, the US administration’s attitude of financing the economy through budgetary deficit put the dollar’s credibility into question until, in the summer of 1971, fears of a worldwide “bank run” convinced US President Nixon to revoke the gold backing of the currency, hence marking the transition from the Bretton Woods “gold exchange standard” to a pure “dollar standard”. However, monetary stability was too important to the European Economic Community, which in 1972 decided to narrow the Bretton Woods exchange rate margins among its members, creating a de facto “snake” within the “tunnel” of Bretton Woods. Historians of the international monetary system described the former part of this story, while historians of European integration focused on the latter. Little has been said on the links between the two processes, and on how they contributed to change the views of the different actors in the policy-making arena over time. In order to undertake this exercise, two countries have been chosen, Italy and the United Kingdom, as they provide interesting viewpoints: the former being politically underdeveloped but very enthusiastic about the European project, while the latter enjoyed stronger institutions but has historically kept a certain distance from Europe.

Policy-makers, a category composed of politicians, civil servants and central bankers, emerge as the core actors; in both cases, international cooperation had to deal with domestic issues, and in both cases fervent supporters and opponents of Europe were present at all levels, creating a seemingly unpredictable interaction. However, a certain pattern could be observed, whereby supporters of a worldwide fixed exchange rates system were fewer and fewer compared to supporters of the European link. The pivotal time of such shift has been identified in the few months spanning from Nixon’s decision to close the gold window in August 1971 until the implementation of the European “monetary snake” in April 1972. Domestic events such as the devaluation of the British pound in 1967 or the “hot autumn” of 1969 in Italy had a less powerful effect. This conclusion also shows that, in both case studies, the monetary choice in favour of Europe was taken on the basis of the demise of Bretton Woods, and hence, of economic interest rather than on the basis of ideology.
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DECLARATION OF ORIGINALITY AND LENGTH

This dissertation is the result of my own work and includes nothing which is the outcome of work done in collaboration except where specifically indicated in the text.

This dissertation does not exceed the limit of 80,000 words set by the Degree Committee of the Faculty of History.

21/10/2009

[Signature]
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CHAPTER 1

BRETTON WOODS AND THE WERNER PLAN: THE MISSING LINK

Economic history has not yet fully taken into account the existence of a causal link between the demise of the Bretton Woods monetary system and the birth and implementation of the "monetary snake", the first monetary system among the countries belonging to the European Economic Community (EEC), which took place at around the same time, between the late 1960s and the early 1970s and which represented a fundamental novelty in terms of European monetary relations. Earlier, but less binding attempts at integration had been brought about by the establishment of the European Payments Union (EPU) in the late 1940s, the European Monetary Agreement (EMA) in 1958, and to a certain extent the Group of Ten Countries (G10) in 1962, seven out of ten members being European countries. The present research is aimed at addressing this issue, therefore trying to understand whether it can be affirmed that a tidal process of Europeanization was in place in the field of monetary relations, basically at the expense of transatlantic loyalty. In doing so, the study will also make the case that such a slow and to some extent even cultural process corresponded to the debate between the supporters of a prospective "one world currency" - as in Robert Mundell's early formulation of 1961 - and the alternative of a world split into two or more monetary blocs, namely at least the United States and Europe or, in the British formulation

2 European Monetary Agreement, Preamble, Paris, 5 August 1955.
3 The G10 was established within the framework of the General Arrangements to Borrow, GAB stipulated in 1962 by several countries belonging to the International Monetary Fund, IMF: United States, Canada, Germany, France, United Kingdom, Italy, Netherlands, Belgium, Luxembourg, and Japan. http://www.imf.org/external/pubs/ft/srv/index.asp?decision=1289-62/1
advanced in the early 1950s by George Bolton and his supporters, the United States and the Sterling Area.  

Europe in the early 1970s, however, was too diverse a community possibly to be described in unitary terms. Hence, a case-study method has been chosen, and two countries have been selected for their particular position regarding the event. The choice of grouping actors by country as opposed to, for example, by type of activity, is not meant to be an implicit tribute to the realist paradigm according to which States, not cross-boundary interests, would be most influential on the international stage. On the contrary, within each case study a significant effort has been made in order to show that there always existed a plurality of actors exerting a more or less heavy influence on the eventual policy-making choices. However, due to the nature of the subject, one must recognize that the debate was indeed structured along domestic rather than cross-boundary lines, for the simple reason that a true international policy-maker did not exist at the time this research deals with, nor did the cross-boundary federations of parties and pressure groups have enough structure and mandate in order to play a relevant role. The most striking impact of this fact is that the formation of policy was much more a function of domestic debates than of international top-level exchanges of views, despite the latter taking place at a ministerial level, both privately and in contexts such as the EEC, IMF and G10. These exchanges, however, did not trigger breakthrough policy-making choices but were simply occasions of intergovernmental cooperation on themes which, in substance, were shaped by much more grassroots domestic drivers, such as electoral cycles or pressure groups, as will be extensively dealt with throughout the present research.

The two countries dealt with in the case studies were selected due to their presenting fundamentally diverse traits on many different levels. On the one hand is the UK, the former centre of the British empire, an industrialized economy affected by economic decline or at least by "declinism"; a country with a stable two-party system and the institutional tradition of some of the oldest democratic institutions in the world, which created an economic power structure centred upon the central bank, the financial power of the City of London, and the administrative branch of the Treasury, a structure challenged from the outside by pressure groups which, themselves enjoying a century-long tradition, were organized by function. Further, the UK was a late comer to European integration, with accession to the EEC dating as late as 1973 - a large wave of Euro-scepticism having gained momentum after Churchill. The monetary arrangements dealt with here certainly played a role in such process. On the other hand is Italy, which had been a founder of the EEC in 1957 and was actually one of the most convinced supporters of the project, be it due to the influence of leftists such as Altiero Spinelli, be it due to Alcide De Gasperi's adherence to the policy lines dictated by the transatlantic ally, that included the formation of a strong and united Western Europe to juxtapose the Soviet bloc. At the same time, the country had been left in ruins by the war, politically and economically, and was experiencing at the same time an economic resurrection (a "boom") and the hardship of having to cope with a backward power structure based on a political control that went much beyond governmental functions, reaching all public and most large private business, the central bank, the financial system and even pressure groups, the latter being organized by ideology as opposed to function. The situation was well represented by the coexistence of a party-state system dominated by the Christian Democratic party. Finally, the presence of the largest Communist party in Europe, which also happened to be anti-European, placed the country in a very peculiar position relative to the rest of its EEC partners.

1. A GAP REFLECTED IN THE INTERNATIONAL LITERATURE

Whenever one opens a book dealing with international politics in the Western hemisphere during the 1960s and 1970s, with very few and notable exceptions, the narrative dimensions tend to be two. On the one hand there is a flavour of what has been referred to as the decline of Atlanticism, with the rise of a more and more bitter argument between the two sides of the Atlantic as to what extent European countries should silently accept to pay in economic terms what the US allegedly provided the West with in security terms.  


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scene, be it due to the swinging strategies of the different American administrations spanning from Kennedy to Carter, or be it due to the domestic or foreign policy attitudes of certain Western European countries that seemed in that period to open their minds towards the acceptance that socialism could be humanized, as long as it rejected its authoritarian drift.

More recently, the historical analysis of that period saw the emergence of a third type of narrative which, despite lacking powerful academic heralds at the time, draws its own perspective from a phenomenon arising during those years. Such a phenomenon was the emergence of Europe as a political subject, which sometimes could even be used in order to refer to the group of European countries that had gathered, in 1957 and then in 1973, in the EEC. Born as a common market, indeed, it was clear from the very outset that the functions of this institution were bound to spill over much beyond the economic arena.

The existing literature on how these events relate to one another is somewhat limited, because of three reasons. First, the illusion generated by historical periodization based in “decades” does not help identify processes that span from one decade to only unveil their consequences during the one that follows. The second reason is that the timing of the collapse of Bretton Woods and of the birth of European monetary integration is indeed too recent to have been fully studied and understood, let alone the fact that many archival documents related to that time were classified until very recently. Finally, these events have not been given a paramount importance in the context of the 1970s as they have been somewhat over-shadowed by other events that took place in the following years, most notably the first oil crisis. Many times the meaning of concepts like "stagflation" have wrongly been attached to the oil crisis itself, rather than considering that the phenomenon was already in place well before 1973.

The first two reasons do not say anything crucial about the importance of these events. The third, instead, seems to suggest that they might not have been as relevant as in the case that is being made here. In itself, however, a lack of attention by historians does not necessarily mean that the subject was not important, or that it was less important than others, especially when it comes to evaluate a period which, being so close in time, technically belongs to history, but practically is still very contemporary: many of the relevant actors are still alive, and many of the decisions taken are still foundations of the present economic and political framework, most notably the European Union and the euro.

Mainstream narratives on the history of international relations mentioned but tended to neglect Bretton Woods, most times by describing the period as dominated by events such as the “ping-pong diplomacy”, or the process of détente initiated by Willy Brandt’s Ostpolitik, and jumping straight from there to the Yom Kippur war and the OPEC oil shock of October 1973. Narratives more focussed on national perspectives may add country-specific elements: the rise of Henry Kissinger within the administration’s ranks, the British accession to the EEC, the retirement of General De Gaulle, the troubled election of Leone as the Italian head of state, and so forth.

Exceptions in this panorama are, naturally, the histories of the monetary system, such as the ones compiled by Robert Solomon, Susan Strange, and Joanne Gowa. Moreover, and as a confirmation that the event had indeed its own relevance, most books that present themselves more or less as biographical memoirs put a strong accent

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8 The term “stagflation” was used for the first time by lain Macleod in a speech to parliament in November 1965. House of Commons, Hansard, 17 November 1965, pp. 1 and 165.
on the demise of Bretton Woods: the Haldeman Diaries, Volcker and Gyothen’s reconstruction, the biographies of Richard Nixon and Paul Volcker, and so forth.

However, none of these international works on the demise of the system takes into sufficient consideration the rise of its European would-be alternative. The mentioned, more recent stream of narratives specifically centred on European integration, instead, offer a fuller account of the process stretching from the Barre Plan to Werner’s proposal of the “snake” to the actual implementation of the latter. But apart from distinguishing between a “snake in the tunnel” and a “snake in the lake”, hence presenting the Bretton Woods troubles in the background, no analysis is developed as to the interaction between the two systems in terms of what drove the former to a breakdown and the latter to rise in exactly the same time framework. Historians of European integration like Derek Urwin and Desmond Dinan built narratives that make sense on their own, without Bretton Woods by treating European monetary integration as a function of the stability that a common market required in order to work properly.

One might even wonder whether, if so visibly neglected by the literature, a connection existed at all. Two reasons seem to testify in favour of such claim. The former is that some narratives in the realm of transatlantic relations have been developed, either soon after the events and more recently, in the sense of suggesting that an interdependence was in place. David Calleo’s writings, from the earlier ones that are contemporary to the events described until the later reflections on Europe from an American viewpoint suggest that the end of the central role of the US in the monetary regime and the emergence of Europe as a new monetary area should be read in the broader context of a slow hegemonic decline, thus being at the same time a part of a larger picture, but also attributing to it an importance which other historians have not, to the point of affirming that “Nixon’s political survival seemed in flat contradiction with the requirements of the Bretton Woods regime.” Furthermore, Francis Gavin’s recent work on the monetary system - carried out with the most recent archival sources - goes in the same direction by describing how the ups and downs of the gold market in the late 1960s reflected the same broader shift.

Moreover, it was suggested that a lack of interest towards the international system had arisen, on the American side, after the experience of EPU in the late 1940s and 1950s, which was correctly highlighted by Kaplan and Schleiminger as a precursor of the idea, even if not of the actual methods, of the European monetary integration that was to take place from the EMA onwards. In order to find good reasons for such neglect, it is worth coming back to David Calleo again, where one finds the claim that “America’s domestic aspirations have been in tension with its responsibilities to a liberal international order.” Joanne Gowa, in the quoted 1973 case study, attempted to explain the reason for this behaviour by hinting that “redressing its position in international monetary policies was much less important to the US in 1971 than was its desire to enhance its control over its domestic economy,” moreover, she claimed that “The ‘low politics’ of money were [...] not to affect the ‘high politics’ of security.” If this is true, then it is possible to see the Breton Woods demise as an important part of a tidal, historical process of hegemonic decline and not, as in Stephen Cohen’s view, as something that “was constructed by the President and a handful of senior advisers during a single fateful August weekend at Camp David” or in Wilfrid Kohl’s words, “another example of royal court decision making.”

29 Ibid., p. 27.
A notable exception to the trend of treating monetary events as a less important aspect of international politics is an economic history of European monetary integration written by Emmanuel Apel, who made a very relevant point as regards the role of Bretton Woods parities in the EEC:

In an attempt to salvage the fixed but adjustable Bretton Woods system of parities, the Group of Ten [...] agreed in late 1971 to change the parity values (or central rates) against the US dollar and to widen the margins of fluctuation around these new parities from ±1 percent to ±2.25 percent. This decision, known as the Smithsonian or Washington Agreement, was ratified by the IMF on 18 December 1971. These widened margins of fluctuation vis-à-vis the US dollar were unacceptable to the Community as they implied a possible maximum bilateral temporal spread of 9 percent between two Community currencies, which was three times as wide as the maximum temporal spread allowed under the EMA provisions. 32

Indeed, the EMA had been signed in 1958 in order to keep European exchange rates more stable than the allowed Bretton Woods bands. Even though the EMA was just a general and non-binding commitment to stability - so that it would be more appropriate to say that the real rationale had to be found in converging national interests rather than in the existing EEC agreement - an explanation like Apel’s is much closer to the case that is being made in this research. Despite not making the point that European countries had rationalized the fact that they were facing a watershed in monetary relations, the author very intelligently explained that it made sense to think of the decline of Bretton Woods and the rise of EEC-centred monetary alternatives as two processes linked to each other. By presenting the EEC as having an ultimately common position, if on the one hand Apel made a daring approximation, on the other hand he pointed out that there is room to affirm that contingency planning in many individual countries had developed in a way that led the Werner Plan to be considered as a viable alternative, rather than a complement, to Bretton Woods.


From a totally different perspective, those historians who concentrated on world politics and on the world economy presented European monetary integration in a very different light, with different degrees of neglect: in describing the international monetary system until 1971, Solomon did not even mention it as a potential driver towards the collapse of Bretton Woods, nor did he see it as something rising partially as a consequence of this collapse. On a more accommodating perspective was Barry Eichengreen: among his publications, the most focussed on the issue was The Political Economy of European Monetary Unification, a volume edited together with Jeffry Frieden. In the introductory chapter, the editors drew a summary of the most relevant events in the history of European integration:

When the Bretton Woods system of par values, which had provided a framework for holding European exchange rates within fluctuation bands of plus or minus 2 percent, finally collapsed in 1971, the European Community’s six founding member states had to focus their energies on limiting the volatility of their exchange rates, lest complaints of arbitrary and capricious changes in competitiveness undermine European solidarity. They resolved to hold their currencies within 2.25 percent bands (only slightly wider than those they had operated under Bretton Woods). They were joined in the “snake”, as this arrangement was prosaically known, by the United Kingdom, Ireland, and Denmark as those three countries prepared to become members of the European Union [actually, the European Economic Community]. 33

Although their presentation opened the possibility of a consequentiality - in a way similar to Apel’s analysis - the events taking place in 1971 were not seen as crucial, nor was the difference between the Smithsonian Agreement and the “snake” correctly pointed out.

2. BRITISH HISTORY: A “FOG IN THE CHANNEL” DISEASE?

The historians who concentrated on British history adopted a somewhat different perspective from either of the tendencies adopted by international historians. Indeed, British historians tended to present both themes. However, the European argument has

been constantly distorted by the fact that these historians’ accounts of the early 1970s obviously dealt with the problem of British entry into the European Community rather than with the more general debate on European integration. In his The British Economy Since 1945, Alec Cairncross described the reopening of negotiations with the European Community, remarking that by 1971 agreement had been reached for entry in January 1973, and as to the financial arrangements, they “involved a British contribution to the Community budget rising to 19 per cent of the total budget in 1977. It had already been arranged to go over from purchase tax to VAT in 1973 so agreement to use the Community system of indirect taxation required no change. Other financial matters - exchange control, debt management, monetary policy, etc. were not immediately affected.”

No reference was made to the connection between European monetary integration and Bretton Woods; on the contrary, the author quoted Nixon’s decision to close the gold window, as well as the collapse of the system, in another passage of the same chapter, as an unrelated event.

In the three-volumes edited collection entitled The Economic History of Britain Since 1700, by Floud and McCloskey, a chapter by Susan Howson specifically dealt with monetary policy in Britain after 1945. The narrative divided the post-war decades up to 1990 into four periods, and the collapse of Bretton Woods - or more precisely, the flotation of the pound in 1972 - was one of the watersheds adopted. However, in the chapter there is no mention whatsoever of British entry into the EEC in the following year. One comes out of this chapter with the idea that, in Howson’s words,

“The new approach implemented in the early 1970s was ‘Competition and Credit Control’ (CCC), formally announced in May 1971. [...] The subsequent ‘troublesome and at times unhappy’ experience included a rapid rise in bank lending and hence the growth of the money supply, with M3 running at nearly 30 per cent in 1972 and 1973. [...] The authorities did not respond idly by, but their reactions were slow - delayed first by fear of unemployment and then by the floating of the exchange rate.”

And this is all she has to say as regards the floating of the pound, the collapse of Bretton Woods, the British choice towards a European monetary bloc, and so forth; it looks as if these events were of little or no relevance to the overall economic history of Britain in the 1970s.

A further presentation of the same story can be found in Roger Middleton’s The British Economy Since 1945, where the political life of the country - and therefore the Treasury - is given much more influence in the economic choices made. Middleton’s description of the British economy has much more to do with “Stop and Go” policies, which allegedly made the business cycle somewhat coincide with the political turnover of Labour and Conservative cabinets, with some exceptions represented by the 1973 and 1979 OPEC oil shocks. As to Bretton Woods and the entry into the EEC, all one can find on the issue is that “[The period 1972-1979] also saw Britain finally attain membership of the EEC in January 1973, and in the previous year, as part of the generalised break-up of the Bretton Woods system of fixed exchange rates, choosing to float the sterling in order to attain a more flexible approach towards weak competitiveness and continuing balance of payments problems.”

On a similar note, Samuel Brittan in 1969 presented the possible future flotation of the pound in terms of traditional economic policy objectives, remembering that it should be adopted as an attempt at reconciling the external objective of exchange rate stability with the internal objective of economic growth.

Jim Tomlinson, the author of another economic history of Britain since World War II as well as a number of articles on the issue, adopted a very similar approach. Instead of focussing on political cycles, he tended to organize his publications along the lines of the different economic policy objectives. Nonetheless, he showed a lack of attention if not towards Bretton Woods, certainly towards the EEC, summarizing the situation of 1971/72 as follows:

“ [...] the designation of the years up to 1971/2 as the Bretton Woods era makes sense in distinguishing it from the sharply different years that followed, characterised by floating exchange rates and more generally by a much less stable economic environment. The new

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Later on, he spoke of the country's accession to the EEC. Interestingly, rather than connecting it to the demise of Bretton Woods, he linked it to the demise of the Sterling Area: "Increasingly Britain's economic fortunes have been linked with the EC and less with the Sterling Area and Commonwealth with which the Area was largely coterminous. The shift away from this Area is obviously linked to Britain's accession to the EC in 1973, but was already apparent before that date. Trading links with Western Europe had been growing, especially from the late 1960s." In this analysis, Tomlinson correctly pointed out the trade reasons for Britain's shift away from the Sterling Area. It is also correct to say that the Sterling Area was brought to an end as a consequence of Britain's entry into the EEC: although the former event actually took place one year earlier than the latter, the demise of the Area was a condition imposed mainly by France before British accession.

What Tomlinson did not explain in this instance is why Britain chose to join the EEC in the first place, and what implications this might have in terms of economic and, more specifically, monetary policies. Indeed, the shift towards Europe during the 1960s - whichever date or event one picks in order to symbolize it - can be seen as the product of a longer process started during the 1950s and having to do with the Sterling Area itself. It is probably not an exaggeration to affirm that such process was rooted in the "two worlds" design proposed by the promoters of Operation Robot, a Treasury and Bank secret plan to guarantee unilateral convertibility and a floating exchange rate to sterling in 1952. At the same time as affirming that Britain needed an injection of international prestige to be brought about by the promotion of the sterling sub-system to an alternative to Bretton Woods, George Bolton and his supporters paved the way to a new monetary strategy that saw Britain no longer as a follower of the United States, but as an autonomous player in a world no longer united by a common system, but divided into several regional systems.

The difficulties, that the Sterling Area would later encounter, made the support for such arrangement fade away, but they did not prevent British policy strategists from continuing to think about alternatives to Bretton Woods. The extent to which such thoughts were realistic is still highly debated, as is more generally the awareness of British policy-makers when it came to economic policy. In his "Treasury Perspective" on the 1960s - as is subtitled his own memoir of those years - Alec Cairncross is not soft with regard to those who in his view were responsible for the "absence of an adequate understanding of the forces at work", an accusation that leads the author to affirm that "When Selwyn Lloyd proclaimed a target of 4 per cent growth it was almost a matter of indifference to him whether he picked 4 or 5 per cent". The overall picture of Britain in the 1960s that emerges from his narrative is that "it is hardly surprising that at the end of the decade Britain shared some of her neighbours' success", a polite way to say that the country did not come out of its troubles thanks to wise policy-making. In all the monetary side of his analysis, however, he concentrated on the solutions offered ("a long series of economic disasters") in order to address the problems of international liquidity and the necessity of devaluation within the existing framework, including the fact that the shift in trade patterns had somewhat changed the UK viewpoint. However, he did not mention either the EEC or a North Atlantic Free Trade Area as possible solutions to the monetary problem. Likewise, Catherine Schenk summed up the UK monetary stance in the late 1960s by affirming that "as the G10 negotiations got bogged down and the SDR initiative did not resolve the underlying systemic problems, the UK continued to seek multilateral solutions to sterling's reserve currency status on the premise that it was in the interest of all major countries that this be managed in a way that did not further disrupt the international monetary system."

Samuel Brittan's study of "The Role of the Treasury" focussed on the same decade, the difference being that he was writing much earlier, and actually very close to the time of the events. In the last revision of 1971, in a section on the EEC he eventually

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39 Ibid., p. 258.
42 Ibid., p. 267.
43 Ibid., p. 275.
44 Ibid., p. 262.
connected the debate on EEC membership with the hope that Europe might have represented a solution to the worldwide monetary problems of a declining Bretton Woods. In so doing, he came extremely close to what the current thesis claims is missing in the literature; however, his easy dismissal of the possibility that a European monetary union might be a solution ("There is no chance of ruling out exchange rate changes between countries with such different traditions of cost and price behaviour") betrays the fact that he viewed the Werner Plan not as an historical watershed in the world monetary equilibrium, but simply as a tool: "The Brussels Commission's insistence on fixed exchange rates in a wider EEC and early monetary union are a classic confusion of ends and means." The fact that the creation of a new monetary equilibrium, replacing the American-centred Bretton Woods, might as well be an end, a historical step, does not seem to even touch Brittan's mind.

In his *The European Rescue of the Nation-State*, Alan Milward offered some insights on the early attempts at EEC membership. Despite not being concerned with the 1960s and 1970s, it is still interesting to read his account of the mid-1950s attempt at broadening the initial ideas on Operation Robot into a European scheme through a European Fund that would shift the monetary fulcrum of the international economy to Europe while creating a "two worlds" situation with Europe and the Sterling Area concuring with the IMF in administering the gold exchange standard regime. However interesting, though, Milward himself is forced to avoid describing this attempt as a turning point in world monetary relations, for the simple reason that it eventually failed and left Britain struggling with the usual post-imperial problems of how to keep an international role without sacrificing too many resources that would be necessary for the domestic economy; on top of that, the Tories of Harold Macmillan chose not to enter the EEC in 1957 - for a number of reasons mainly centred on economic evaluations of national interest - opening up to a period of renewed "fog in the Channel" that would last until the end of the following decade.

Drawing an Urwin-type narrative of European integration in the context of a volume on British economic history, Bernard Alford is the British author who came closest to linking Bretton Woods and European integration. At least, he put them in the same chapter and described them as consequential. However, his reasoning went as follows:

[In 1972] the operation of a floating exchange rate allowed British prices to rise faster than the world rate of inflation. A depreciating exchange acted as a kind of automatic transmission that maintained external price competitiveness and insulated domestic inflation, at least for the time being. [...] 

[By 1973] Britain's external financial problems were exceptional among the major economies, but this did not mean that there was a complete lack of shared concern about the structure of international finance. To the contrary, within the European Economic Community there were growing worries about the role of the dollar and the possibility of the German mark being attached more closely to the dollar in opposition to other major currencies. These concerns crystallized into a proposal in late 1977 for a European Monetary System.

Why wait until 1977 - five years since the flotation of the pound, four years since the final breakdown of the Bretton Woods rules - in order to find the seeds of the European monetary unification that had already been put on the table at least since the Hague communiqué of December 1969? The question remains unanswered.

Frank Blackaby offered an explanation where at least a logical link between flotation of the pound and "monetary snake" is acknowledged. While quoting the 1972 budget speech's intention not to allow the exchange rate "to stand in the way of economic expansion", he observed that

Before the rate was floated in June, there was in fact a move in the opposite direction. Towards the end of April the six members of the EEC took the first step towards a European Monetary Union by agreeing to narrow the range of fluctuations in their exchange rates. On 1 May Britain, as a candidate for the EEC, joined what came to be known as the "snake in the tunnel."
However, the author himself seems to limit the scope of this claim by affirming, one paragraph later, that the UK “still believed that a world system of fixed parities was desirable”.

In his previously quoted work on British monetary policy, conducted through his typical structure of policy objectives, Tomlinson hinted that “The logic of the floating of the pound in 1972 was to free the economy from a constraint,” in line with Mundell’s scenario of regaining control over monetary policy at the expense of exchange rate fixity. Then, the author went on to affirm that “there is a simple logic in Britain’s membership of the exchange rate mechanism of the European Monetary System, which may be seen as trying to regain a policy capacity at international level which has been largely lost at a national level.” As is easy to notice, therefore, the detachment from Breton Woods and the choice of joining the European project are presented as stemming from different causes, the former being driven by the necessity to steer the domestic economy, the latter stemming from the idea of regaining at least a part of the international prestige that the country had lost during the previous decades. However interesting this explanation might be, especially its latter part, Tomlinson therefore did not create a consequential link between the two choices.

Was there really no link? In an earlier work, Catherine Schenk seemed to build at least a link between the phasing out of the Sterling Area and the emergence of Europe as a monetary framework including the UK, in that “The sterling area enjoyed many of the benefits of a currency area described in the theoretical literature” - referring here to Mundell’s classic work on the issue. During the 1940s and 1950s, she pointed out, “Sterling area exports to Europe also contributed to economic recovery and improved the British position in the EPU.” At the same time, “The most important aspect of the sterling area as a currency area is where it fell short of the theoretical prerequisites. A primary weakness was the lack of common policy goals after the end of the dollar shortage.” According to Schenk, the debate over the sterling area eventually fostered the idea of an EEC-based currency area, which would address the issue of the lack of common policy goals. Adding up to that, a trade argument was also in place, as seems to be acknowledged by Cairncross who, although indirectly, observed that “Exports to sterling-area countries had been flat or actually falling for some years and were down to 35 per cent of the total while exports to the six members of EEC had risen from about 11 per cent to about 15 per cent.”

Richard Roberts has recently conducted a study of sterling, with an unprecedented depth of analysis. His ultimate conclusion is very concise: “The links between [the sterling crises of 1967 and 1972] and both the breakdown of the fixed exchange rates system in August 1971 and February/March 1973 and the postponement of the achievement of monetary union by the EEC for two decades were indirect and not decisive,” which is tantamount to saying that the British domestic problems - or at their broadest, the sterling area problems - were not decisive in bringing about the shift between the former and the latter system. Yet, Roberts does not seem to infer anything as to the existence of a causal link in this shift, apart from acknowledging that on 7 March 1972, when the EEC announced the forthcoming launch of the “snake”, “The foreign exchange market perceived the move as greatly increasing the likelihood of a concerted European response to further inflows of dollars, either through new capital controls to manage the system or through a joint float against the dollar.” In essence, the scope of the current thesis is to complement Roberts’ claim with the addition of such a causal link.

Interestingly, Michael Oliver and Arran Hamilton have touched on the theme of the relationship between Bretton Woods and a possible European alternative when assessing an earlier historical event, namely the sterling devaluation of 1967. Thanks to newly available sources, they managed to draw a connection between Bretton Woods

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and "a European bloc floating against the dollar", coming to the conclusion that by mid-1969 "the strength of the official reserves of EEC countries taken together, [however] formidable at the end of 1970, could only realize its potential 'when separate nations combine their reserves [...]'." Despite not being the central point of their work, Oliver and Hamilton's point here is exactly what the current thesis will focus on, and highlight. Indeed, if it makes sense to use it as a by-argument in a narrative on the devaluation of the pound, yet it should be pointed out that, in broader perspective, it is the idea of this tidal shift that is going to become a fundamental feature of the monetary history of the post-war period, as it represents an important marker in the process of erosion of US monetary hegemony. The task of the current thesis is to prove that such shift ought to be attributed this importance.

3. ITALIAN NARRATIVES: HISTORIOGRAPHY AND MEMOIRS

The historiography concentrating on Italy can be divided into two streams, one effectively belonging to economic historians, the other developed by the relatively few collections of memoirs that have been compiled. On the economic historians' side, the main accounts are Augusto Graziani's economic history of post-war Italy, and Spinelli and Fratianni's monetary history of Italy, that reached the time framework dealt with in this thesis. Neither of them attributed a great importance to either Bretton Woods or the monetary snake. The former is concerned with the consequences of the "hot autumn" and then jumps immediately to the oil shock of 1973. The latter authors, instead, are busy telling the story of Guido Carli's focus on economic growth, the "cost-driven inflation" hypothesis and so forth, while they suffer from the same bias as Graziani's in that they have in mind the oil shock and the "hot autumn" while not considering the important, tidal change that took place in between. One further account of monetary history in the early 1970s is a study of the Bank of Italy by Gianluigi Mengarelli; but again, the collapse of Bretton Woods is not even mentioned in the narrative. Bretton Woods and the monetary snake suffer from the same neglect in Michele Salvati's chapter on post-war economic history within one of the most acclaimed histories of Italy, that is, Sabbatucci and Vidotto's. In this case, however, the author offered precise reasons for his choice: "between the end of the Sixties and the beginning of the Eighties there is a turning point in the process of development, worldwide, a turning point that leads - to quote the most evident consequence - to roughly cut by a half the growth rate of incomes in the economically developed countries." Hence, he claimed, something must have happened in between: both the collapse of Bretton Woods and the post-oil shock inflationary spiral of 1973-1975 had been given a mainstream interpretation in line with Paul McCracken's famous report, which affirmed that the effects of these events were reversible insofar as both had taken place due to an unlucky mixture of exceptional circumstances and wrongly restrictive economic policies. However, Salvati observed that by the end of the decade it had become clear that the "golden age" was over and it would not be resurrected by a comeback of Keynesian policy-making. By drawing this decade-long picture, then, the author goes on to affirm that the event that epitomized the problem was the 1975 inflationary recession, which hit Italy in a particularly hard way. In doing so, he no longer takes into account the changed monetary scenario, which is a pity, as the Italian currency had to struggle for substantially different goals from those pursued under Bretton Woods, in particular as there was a shift from ideological support to a contingency planning mood, implying that the goal of exchange rate stability could be more easily placed lower in the concerns of policy-makers.

In this general atmosphere of international monetary policy neglect, it is Marcello De Cecco who, in a 1977 account of the economic policy scenario during the 1960s, provided the most insightful observation as to why European monetary integration, at least from an Italian perspective, had not been considered earlier than the late years of the decade:

"The European monetary authorities, indeed, in order to solve, halfway through the decade, their own national troubles, birthed a 'private' international monetary system which became an alternative to their own national systems, hence representing a powerful mechanism of neutralization of national monetary policies, and on top of that, getting in the way as the principal obstacle to any attempt, or even hypothesis, of European monetary integration. In the Eurodollar market, European monetary authorities appeared, towards the end of the decade, as nothing more than big private operators, whose power was proportioned to the respective financial capabilities. But they completely lacked, in such market, what should have been their main feature, that is the power to enforce, in those instances in which they could not convince through their action as simple financial intermediaries."

However insightful, De Cecco’s analysis of the links between international monetary policies and European integration terminates here.

Notably, there is a stream of Italian historians of European integration, gathering around Vera Zamagni and offering a version of post-war continental integration from Italy’s specific point of view. Despite mentioning Breton Woods, however, Francesca Fauri’s history of European integration concentrates on the different phases of the “snake” without too much connecting the latter to the former’s demise.

As far as memoirs are concerned, Giulio Andreotti and Ugo La Malfa have certainly published the most. Other people relevant to policy-making published books that may be considered half-way between a collection of memoirs and historiography, as is the case of Sergio Romano’s “guide” to Italian foreign policy. None of these have ever dealt with monetary issues in full; but this cannot be considered as a relevant datum in order to prove the latter’s irrelevance to the broader historical picture. Indeed, the broad scope of these works, as well as their political rather than economic focus, would not have motivated a specific attention to the balance of payments issue. It should be remembered that Breton Woods made newspapers headlines for ten days in a row during August 1971, which was an absolute exception for monetary issues, that otherwise tended to remain in the background and not to be dealt with by the man of the street.

4. STRUCTURE, SOURCES AND METHODOLOGY

The above survey of the existing literature gives a general overview of the gap in the literature mentioned at the outset. Although clearly incomplete, it should also have raised a question as to how relevant the collapse of Breton Woods was in the process of European monetary integration, and what policy-makers thought about it: either the existing literature failed to give enough consideration to a link that existed, or this link did not exist in fact. Moving from surveying the literature to building a narrative, Chapter 2 will sketch out the theoretical and practical background of policy-making in the two countries considered by the present research, in order to provide the background to the case studies that will be presented in the following chapters, and that will tackle the question of whether or not Breton Woods was actually relevant to European monetary integration.

After doing that, the case studies will be presented: Chapters 3, 4 and 5 compose the case study on the UK, while Chapters 6, 7 and 8 present the case study on Italy. In order to understand whether it can be affirmed that a tidal process of Europeanization was in place in the field of monetary relations, basically at the expense of transatlantic loyalty, it is necessary to explore the process of policy formation. For each case study, therefore, the discussion has been split into the description of the position of the various public actors involved in such process before the suspension of the gold convertibility of the US dollar on 15 August 1971. One chapter is devoted to the actual policy-makers: the political coalitions expressing the cabinets, the oppositions, the central bank and the governmental civil servants. One further chapter then looks at actors who were less directly involved in policy-making, that is, all the pressure groups relevant to economic policy: trade unions, business associations, organized finance. Once described each actor’s position before the event, a chronological narrative is introduced in order to mix them all, in an attempt at explaining how and why most of these actors shifted from their original positions, or influenced someone else’s views, and how such interaction

70 Ugo La Malfa, L’altra Italia, Milano, 1975.
71 Sergio Romano, Guida alla politica estera italiana, Milano: Rizzoli, 1993.
72 Corriere della Sera, 16 to 26 August 1971.
ended up creating, in both the cases analyzed, a much more European-centred monetary thinking than was the case in the years preceding the demise of Bretton Woods.

Archival evidence that has been recently declassified, and that filled the gaps which prevented historians from developing a strong case in this sense, has now been collected as part of the research for the present work. Such material will be unfolded by describing the mutual positions of the relevant actors of the time, from the actual policymakers - government and central bank - to collective and individual positions and debates within other institutions that had something to say, with a different degree of relevance, regarding policy choices in the monetary field: parties, trade unions, media. One might object that the framework adopted is stereotyped: "where are the other actors?", "where is civil society?", "where are the networks of associations?" - one might wonder. Actually, one must recall that before the mass-media revolution of the 1980s and 1990s, direct forms of bottom-up communication were not conceivable; hence, the formation of public opinion passed through institutions. What has been left aside, therefore, has been consciously excluded due to a criterion of relevance and not due to an alleged institutionalism. While it would be rather blind to do the same nowadays, it was not the case in the early 1970s: associations other than the largest trade unions would never have the possibility to get together and acquire visibility as was the case of the civil society movements of the internet era (with the violent exception of terrorism, which managed to gain media coverage in both countries, but which luckily did not succeed in transforming its presence in the media into real political influence). Smaller groups have therefore been left aside: some small right-wing parties, the smaller trade unions and business associations, the Catholic and Socialist associations in the case of Italy; nor did any of these groups have a reason or a rationale for promoting a foreign policy view.

The following chapters build on the general policy-making background sketched here, in order to address the gap in literature that was outlined at the outset. For the sake of precision, however, one further methodological observation needs to be made just before tackling such an exercise: the structure of the case studies remains rather peculiar in trying to consider actors that have been studied by different scholars adopting a broad range of analytical frameworks. The choice made here has been to maintain the structure of these frameworks as much as possible, so as to reflect the scholarly work that has already been carried out on the subject. The only major departure from this guideline has been the preference for the adoption of economic, as opposed to political or diplomatic, viewpoints. On the one hand, the latter two perspectives clearly do not run any risk of extinction within this research, due to the nature of most primary material, which basically comes from diplomatic and political sources. Secondly, a definitely economic focus will also help contain criticism as to the conclusions reached: instead of selling the results of this research as an all-encompassing answer to the question on whether the collapse of Bretton Woods changed the policy-making conditions in the European context, in this way they will be necessarily limited to affirming, in the best case, that for many actors the changed economic framework represented a rationale for shifting opinions.

The author himself will be the first to keep in mind that, as Tinbergen put it, "economic policy, like any real activity, has to reckon with many aspects originating from very different realms of life, and hence certainly not only economic viewpoints". Adding to that, if one accepts that States are not - or at least they can no longer be - coherent actors in the context of international relations, then it is fair to define history as the unpredictable interaction of independent subjects. Of course, both these observations bring a lot of complexity into the picture; but they also make historiography resemble human life, in its being a fascinating and never-ending exercise of approximation.

CHAPTER 2
THE POST-WAR ESCALATION TO MONETARY FAILURE

Once it is claimed that the existing literature neglected the link between Bretton Woods and European monetary integration, the first consequence is the need to revisit the narrative leading to the climax of 1971-72, in order to describe the build-up that led to these events. This will make it possible to highlight the historical elements that motivate the claim set out at the outset, which will be tested with the help of archival evidence in the core chapters of this work.

1. THE EARLY YEARS: AMERICAN LEADERSHIP, MONETARY DILEMMAS

For a start, it is useful to consider that the sense of political and economic unpredictability, so clearly detectable in the international economic picture of the 1960s, was rooted in the unique situation that had been experienced throughout the West during the early post-war decades. Historically untested paradigms - the welfare state, embedded liberalism, Keynesian economics, the American role in financing the reconstruction of Europe, the continental integration implicit in the creation of EPU - had been introduced either with enthusiasm for the newly created world order, or with the fearful acknowledgement that all previous orders had ended in a failure ranging from crisis to catastrophe.2

The American leadership over the fast-changing economies belonging to the transatlantic area had reigned uncontested thus far, with minority views within domestic political arenas, but no major challenge to Atlanticism in any field of policy, including monetary relations. The fixed exchange rates system set up at the Bretton Woods

conference of 1944 had been conceived in order to guarantee worldwide exchange rate stability, and it stemmed from the acknowledgement that exchange rate risk hindered international trade, while the latter was considered as a positive sum game and had been one of the uncontested tools of the *pax americana*; despite mercantilism being still well alive among theorists. On the contrary, an international competition on progress was - somewhat unconsciously - introduced by the statistical studies on economic growth carried out by OECD in the post-war decades.

I.1. A Fixed But Adjustable Rate (FBAR) regime

While moving out of the pre-war mercantilist economic dynamics, and subsequently also out of the post-war economics of reconstruction, most countries in the transatlantic area seemed to have found the way to bury the ghosts of their own past in the pursuit of prosperity. One of the lessons learned from the inter-war period had been that economic disparity among countries tended to become a source of international trouble, hence, a massive scheme of financial aid was put in place by the US in favour of the European economies. The Marshall Fund for reconstruction provided the remainder of the West with funds denominated in American dollars, while EPU managed the clearing of intranational payments exchange before rate restoration and convertibility was possible. Technically, the Bretton Woods system was characterized by a narrow fluctuation band of 1% each side of the official parity, the latter being adjustable in order to allow for one-off shifts larger than such range, in case a "fundamental disequilibrium" had arisen. It was a Fixed But Adjustable Rates (FBAR) regime, even though such definition was only to come out much later, and so was the awareness of the downsides associated with it.

The years before the restoration of full convertibility in 1958 were not always easy for the exchange rates regime. The arrangements of EPU, as well as those underlying the Organization for European Economic Cooperation (OEEC) which was to manage Marshall aid, were not universally praised. In war-torn countries like Italy, the acceptance of such arrangements was accompanied by a long ideological struggle between the Christian Democrat core of the political spectrum and the more leftist parties, especially the Communist Party, which claimed that such organizations were simply projections of American power intended to ensure Europe’s subjugation. The Christian Democrats, on their side - joined by most of the social right, as Sergio Romano recalled - looked at EPU and OEEC as the new way forward towards a worldwide trade and monetary system that would underpin global peace.

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1 These views had been originally advanced by the ideologists of Breton Woods, the British John Keynes and the American Harry Dexter White, and were later theorized into “embedded liberalism” by John Ruggie, “International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order”, *International Organization*, 36, 2, Spring 1982, pp. 379-415.
6 “World War I had destroyed the international monetary system based upon the gold standard. [...] competitive devaluation” was practiced by many countries during the Great Depression of the thirties and led to a sharp reduction in world trade.” Laura LaHaye, “Mercantilism”, in *The Library of Economics and Liberty*, [http://www.econlib.org/library/Enc/Mercantilism.html](http://www.econlib.org/library/Enc/Mercantilism.html), 2007.
9 European payments before the effective restoration of convertibility for national currencies was possible. Technically, the Bretton Woods system was characterized by a narrow fluctuation band of 1% each side of the official parity, the latter being adjustable in order to allow for one-off shifts larger than such range, in case a “fundamental disequilibrium” had arisen. It was a Fixed But Adjustable Rates (FBAR) regime, even though such definition was only to come out much later, and so was the awareness of the downsides associated with it.

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12 According to Max Corden, the most important of these downsides is a psychological constraint: when a rate is adjusted once, nothing prevents markets to expect it to be adjusted a second time, hence breaking the illusion of the elimination of exchange rate risk. Max W. Corden, *Too Sensational: On the Choice of Exchange Rate Regimes*, Cambridge MA: MIT Press, 2002. However, in the case of the 1967 devaluation, a number of considerations had made policy-makers think exactly the opposite, the main argument being that investors would have been more afraid of an overvalued pound than of a pound adjusted once. Michael J. Oliver and Arran Hamilton, “Downhill from devaluation: The battle for sterling, 1968-72”, *Economic History Review*, 2006.
13 “The subjugation of Italy to NATO and to America [...] are heavily influencing the entire political evolution, as well as economic development - not least through the inflationary pressure of the dollar [...]” – *Direzione PCI*, “Una politica democratica e di riforme per risolvere i problemi economici e sociali”, Rome, 8 July 1970. PCI, *Politica Economica Italiana 1945-74*, Bologna: Istituto Gramsci, p. 255.
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\(\textit{A.O. Hirschman, National Power and The Structure of Foreign Trade, Berkeley: University of California Press, 1945.}\)


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ideologists had a clearly different view as to how international peace was to be achieved.16

The countries which entered and exited the war as democracies were, apparently, struggling less with the acceptance of the new international order. The UK never opposed EPU in public. However, the debate inside the different policy-making circles was somewhat more open. EPU was clearly a step towards the convertibility of European currencies, and the 1950s witnessed a number of opponents to such idea, based on the fact that the cost of such convertibility in monetary policy terms would not have matched the benefits of easier trade with Europe in a country that, like the UK, had more trade ties with the Commonwealth than with the continent.17

1.2. The Triffin Paradox

The field of economic policy was also one of the most heavily involved in rapid changes of views.18 As the years went by, and in particular when in 1958 the convertibility of most currencies was restored, more problems started to arise. One side-effect of currencies being convertible into one another was that each country had to deal with the potential spill-over of monetary policies conceived abroad, as shown in Figure 1.

Moreover, the central country of the system was expected to finance the liquidity of international trade by running a constant financial account deficit; alternatively, it could have refrained from doing so, but the consequence would have been a slow down of the world economy. In the former case, the situation would build up until the system would experience a run on the dollar; in the latter case, the breakdown would be brought about by a liquidity crisis. This was Robert Triffin’s formulation of the problem, in the famous “paradox” he advanced in 1959.19 Whether it was due to the strictly economic reasons suggested by Triffin, or to the expansionary policies pursued by the Kennedy and Johnson administrations, followed by Nixon’s “benign neglect”,20 it is a matter of fact that the “paradox” well summarized the main problem the international economy faced throughout the 1960s, with an American balance of payments deficit threatening to destroy the system.

![Figure 1. Effects of a rise in the foreign interest rate on a small economy (fixed exchange rates).](image)


This imbalance, accompanied by the idea that the US was pursuing policies beneficial to its own view of the world order, but not so beneficial to European countries as such - the Vietnam War being the most striking example - generated waves of discontent and a search for alternatives that went much beyond Triffin’s analysis. In

16 "it is necessary for Italy to adopt a new foreign policy [...] along the lines of defense, peace, European security, overcoming the bloc [...]" Direzioni PCI, "Una politica democratica e di riforme per risolvere i problemi economici e sociali?", Rome, 8 July 1970. PCI, Politica Economica Italiana 1945-74, Bologna: Istituto Gramsci, p. 253.
17 The shift in trade patterns towards Europe not yet being visible, one had to resort to idealist claims in order to sustain the contrary, as was the case of the internationalist Keynesians who sustained Britain’s integration in Europe with general free trade arguments. Economist Intelligence Unit, Britain, the Commonwealth and European Free Trade, 1958. Richard Iver, Geoffrey Williams, Alan Lee Williams, and Glyn Mathias, Europe or the Open Sea?, The Political and Strategic Implications for Britain in the Common Market, London: Charles Knight and Co., 1971, p. 84.
1963, the French economist Jacques Rueff, an advisor to General De Gaulle, proposed a return to a pure gold standard, in which the US would no longer enjoy the "double loan mechanism" that allowed it to run a virtually endless deficit.21

1.3. A downsized UK between Operation Robot and economic decline

Moving from the international stage to the domestic debates and strategies developed within the countries that are the subject of the two case studies, one begins to find a preliminary ground for the thesis advanced here. For a start, the UK debate on the monetary regime did not make the same international noise as the French one; but that must be mainly associated with General De Gaulle’s sizeable personality rather than to a lack of such debate within Britain’s shores. Indeed, Rueff’s ideas on Breton Woods might be associated with those of at least two very influential British counterparts: George Bolton in the 1950s, and Samuel Brittan mainly from the 1960s onwards. While neither suggested a comeback of a pure gold standard - for the reasons explained above - Bolton would be one of the main supporters of the view that, unless action was taken, the West would face an "end of civilization".23 Also Brittan, a Financial Times journalist, was a strong supporter of floating exchange rates, supporting the view that it was the Sterling Area arrangement, instead of Breton Woods or the EPU, that Britain


22 When in 1965 the French president threatened to exchange the country’s dollar reserves into gold claiming that the US was enjoying an “exorbitant privilege” within Breton Woods, it was Rueff’s theory that was brought forward as the rationale for such claim. Charles De Gaulle’s press conference of 24 February 1965 is mentioned, among others, by Francis J. Gavlin, Gold, Dollars and Power: The Politics of International Monetary Relations 1958-1971, Chapel Hill: University of North Carolina Press, 2004.


ought to have defended in order to promote its own economic interest.24 Overall, the UK was trying to defend its existing international role, and its policy-makers were therefore wondering whether a shift out of an Atlantic loyalty would have been harmful or beneficial to the British people.25 Indeed, post-war UK had to downsize its international expectations from the culture of the empire to that of a second-class financial centre. While "the pound to a great extent recaptured its place as the primary trading currency" between the wars, it is also true that, as Kathleen Burk vividly pointed out, "in the end, capital told. [...] And with the abandonment of the gold standard in September 1931 and sterling’s eventual fall in value from $4.86 to $3.49, the pound again resigned its former position as a trading currency."26 Furthermore, the Bretton Woods agreements made it clear that the centre of the post-war system was the US dollar, although the Sterling Area countries maintained a fixed ratio of their own reserves in the British currency, their size was not comparable to the amount of those in dollars.27

Many of the theories claiming the existence of an international decline of Britain emerged during these decades, as has been extremely well summarized by Jim Tomlinson.28 In the early post-war years, psychology had an edge over statistical data, the latter not being nearly as widespread as they came to be afterwards, as Richard Toye observed while describing the emergence of "declinism" within the ranks of the Labour party.29 Remarkably moreover, British historians did not limit themselves to describing this decline from an economic perspective: "the agrarian and aristocratic stamp of English rulers in the era of the Pax Britannica" was at the core of such decline according

to Anderson, who supported the view that the problem was determined by "the cadet role of industrial capital in the Victorian age."

Whichever name or causal explanation is chosen for such decline, the shift of most financial activity to the US during the interwar period was a rather evident manifestation of it. In the words of Cain and Hopkins, "in the event, the chief beneficiary of the boom of 1925-29 was the US, whose economic penetration of Europe foreshadowed the larger invasion that was to come after 1945." On top of that, more easily measurable domestic issues were clearly at the core of the debate over the economic troubles facing the UK from the very beginning of the 1960s, one of which - the monetary situation - is the focus of the present research. Industry, indeed, was overall favourable to fixed exchange rates for the stability they would represent for international trade. If this had already been the case during the interwar period, it was still the driver of industrial views in the 1960s. Once accepted that the UK played a deputy role, after all it was not a problem if the US benefited more from that, as long as the British economy could enjoy the situation too.

The difficulties encountered by the Sterling Area, as suggested by Schenk, can be broadly divided into the three types of relations that such an arrangement implied: "the sterling balances, international trade and long-term capital flows". Both the first and the second type involved debate over the sterling balances, in which the mainstream view was provided by the 1957 Radcliffe Report: "the relationship between reserves and liabilities was clearly far from satisfactory throughout the post-war period and remain[ed] so", the consequence being that the country would be more exposed to potential runs on national reserves. An important corollary of this view was that "the United Kingdom was in the unhealthy position of borrowing short and lending long", meaning that the sterling balances were a source of short-term finance for Britain, which in turn invested heavily overseas - exactly the opposite mechanism from the one that would be necessary in order to profit from this relationship. Trade ties, which had been strong and commonly viewed as overall advantageous to the UK until the 1950s, were declining in importance "as the RSA became less reliant on the British market for their exports."

The Tory governments of the immediate post-war years, initially led by Churchill and then Eden, Macmillan and Douglas-Home in the years up to 1964, had formally been favourable to Breton Woods for its alleged role as a stabilizer for the world economy. Under the bench, however, policy-makers had been responding to the still existing demand for world leadership by trying to shape the country's foreign policy in a way favourable to the ideas on Britain's international prestige, still deeply rooted in national feeling.

It is this framework that Operation Robot was conceived in 1952: basically a plan for general exchange rate flexibility, aimed at ensuring Britain's advantage at the expense of other countries and, possibly, of the liberal system of international trade. The main developers, Leslie Rowan, George Bolton and Otto Clarke - from whose initials the acronym "Robot" - were clearly oriented towards this, in the conviction that a "two worlds" system, in which the Sterling Area would compete with Breton Woods, would be positive for the UK economy.

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Relevant players, however, did not quite see it this way. The City, for instance, looked at exchange rate fixity as a saving, since financial investments need not be hedged against exchange rate risk. Moreover, London was no longer the world’s financial centre, but it definitely remained Europe’s hub - the competition with Frankfurt as well as the Eurodollar phenomenon being yet to come - and this central position was fostered by the existence of easy and secure international capital movements, in turn eased by exchange rate stability.

As has been pointed out, the European arrangements of EPU and OEEC were also prototypes of European integration. But if involved in a “Robot” type of strategy, why should the UK enter these European schemes at all? The first reason was that, as said, not all of this strategy was to become public, and the participation in EPU and OEEC - wanted by the Americans - offered a perfect cover to the plans mentioned above. Secondly, at least to a certain extent, post-war leaders such as Churchill had sincerely believed in Europe.

1.4. Italy’s predictable foreign policy lines

In the same years, Italy was in a rather different position. The decision regarding which policy lines were to be followed did not stem so much from economic theory as from political considerations: continental integration had always been looked at as an opportunity to promote the country to an international role - after the shameful experience of the interwar dictatorship - and the monetary choice tended to be a function of a broader debate on the foreign policy loyalty that the country should have adopted.

After the watershed of the 1948 elections, and then the confirmation of the Christian Democrats led by De Gasperi in 1953, the centre-right cabinets as well as the central bank were well aware of the limitations on foreign policy freedom that the country was to follow in order to make its own way into the post-war order. The 1950s, labelled as the age of the destra storica (“historical right”), saw the national currency being strenuously defended at the official exchange rate parity, a commitment broken only once in 1947, and then always maintained at 625 liras per US dollar. Monetary stability provided Italy with the export-led growth that was necessary for the economic miracle, as was unanimously acknowledged: both Andreotti and Romano described it as a founding element of the country’s foreign policy, and the Italian promotion of European integration pursued by numerous politicians was never intended to challenge exchange rate fixity. The central bank’s governor, Menichella, seemed determined to keep the Bank “a discreet place, outside the sphere of attention of politicians, economists and mass-media”, in which policies could be carried out in strict compliance with the official goal of guaranteeing the stability of prices, and doing this as a counterbalance to the government’s chosen fiscal policies.

1.5. Full convertibility, and the emergence of new policy paradigms in the UK

While US administrations of both colours managed a build-up of a partly imaginary and partly real bipolar confrontation with the Soviet bloc, European economies recovered, and the dollar gap that hindered liquidity in the first post-war decade was substantially reduced. Towards the end of the 1950s, it was possible to guarantee each currency’s convertibility into one another, at which stage EPU was dissolved. The restoration of convertibility was accepted in the UK thanks to the positive attitude of the Bank of England’s Governor, Cameron Cobbold, and of Chancellor...

Richard Butler, as well as a more general reversal of the positions expressed earlier in the decade by the "Robot" officials. George Bolton in particular had shifted to a more accommodating position. Indeed, on the one hand, convertibility implied that the British pound, despite keeping a regional role, would decline in importance; in this respect, if not the EEC or a Europe-based free trade area, at least a North Atlantic free trade agreement might have been more appealing than the current arrangements for British foreign trade. And on the other hand, convertible currencies accompanied by freer trade might have fostered Britain's competitiveness around the world, as in the FBI's already mentioned stance; moreover, thanks to the City's role as a European financial hub and the eurodollars phenomenon, Britain would have been better off by opening up its trade relations.

A European monetary system as such was not yet in sight at this stage. Moreover, convertibility had a relevant cost in that it led to increasing difficulties in keeping international capital mobility under control. As theory and then practice showed during the early 1960s, it proved harder and harder for national governments to keep the exchange rate fixed while at the same time dealing with larger capital mobility, and this was only possible at the expense of domestic monetary policy.

As part of a broader analytical evolution that was bringing a number of new understandings on the tools of economic policy-making to the surface, a very influential explanation of the problem was advanced by Robert Mundell and Marcus Fleming in two papers of 1962 and 1963. The two American economists suggested an "impossible trinity" in economic policy-making, according to which exchange rate stability could only be attained by giving up either international capital mobility or the use of monetary policy in order to steer the economy. Mundell's prescription, as in Figure 2, would have been to use fiscal policy in order to do what monetary policy could not do.

![Figure 2. Two different ways to aim at the full employment target.](image)

At around the same time, the first real departure from the post-war transatlantic loyalty to "embedded liberalism" emerged. A more flexible exchange rate was the implicit prescription of Milton Friedman's "monetarism", in that an increase in the money stock is "the single necessary and sufficient condition for a sustained rise in the money price level"; then monetary policy freedom was paramount and - thinking in terms of the impossible trinity - it should not have been sacrificed on the altar of exchange rate stability, whatever the role of the latter in fostering trade. Once it was claimed that monetary policy should remain in the hands of governments for the pursuit of domestic goals, two scenarios were possible: either to give up capital mobility, or fixed exchange rates. The former was unrealistic. Hence, monetarism claimed, if there

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54 Ibid.
was a tension between monetary policy freedom and exchange rate stability, it was the latter that had to be abandoned. It was a fascinating theory, as yet new and untested, and to a conservative-led cabinet it had the great appeal of presenting itself as an alternative to the "Stop and Go" policies developed by Keynesians, for which "economic policy was largely a tightrope with unemployment on one side and balance of payments deficits on the other".59

Even if, as Brittan observed, "the British Treasury [did not] accept Chicago doctrines lock, stock and barrel", at the same time something was moving in that direction: "What took place would be described in Whitehall language as a 'shift of emphasis' in their direction".60 Between the 1959 Radcliffe Report's statement that monetary policy could not sensibly affect demand "unless applied with a vigour which itself creates a major emergency" and Reginald Maudling's expansionary package of 1962-64, there is a great deal of difference.61

The existence of these different views also provide part of the explanation of the changing British attitude towards the monetary regime during the 1960s. The outcome of Maudling's "experiment" was a balance of payments crisis in 1964, contemporary to the Tory electoral defeat that started Harold Wilson's first administration. The persistent subordination of monetary policy to fiscal expansion had clashed with the "impossible trinity", and the international rules of the game required a domestic adjustment as opposed to compensation through a shift in the exchange rate. It comes as no surprise that such a constraint also came to be looked at as a burden by Maudling's successor, James Callaghan.62

It is at this stage that the first ideas on European monetary integration started to emerge. Arguably, the very first communities of Europe had been the EPU and OEEC. By 1955 the mainstream view, as expressed in the preamble to the EMA - the monetary treaty stipulated among most European countries under the auspices of OEEC - was that European countries were willing to establish monetary cooperation among them.63

2. INFLATION IN THE FBAR REGIME: THE "DOLLAR GLUT" (1963-66)

An opposite trend towards European unity was visible overseas: the support of the United States towards a European super-state faded away as soon as it became clear, by the early 1960s, that a "dollar glut" was replacing the previous shortage64 and a potential economic adversary had risen.65

The 1960s were also years during which new and unexpected problems started to arise, which economic theory was not yet able to address, the most pressing one being that inflation came together with declining employment despite the Keynesian trade-off that was theorized by Phillips in his famous "curve".66 Governments struggled to find answers to this, while data were increasingly showing that inflation and unemployment could, indeed, come together, as shown in Figure 3. Since the restoration of convertibility and given the growing interdependence of economies especially within the West, capital controls would become less and less enforceable. Provided that monetary policy freedom was necessary to governments in order to address these new problems, Mundell and Fleming's analysis implicitly suggested that it was perhaps exchange rate stability that had to be given up.

61 Maudling's motto was Alfred Marshall's subtitle to his 1890 macroeconomics masterpiece: Natura non facit saltum, "Nature does not move in leaps"; and as Brittan recalls, "although [he] was sometimes a bold conversationalist he was cautious in his actions". However, the rise in public expenditure he approved for the 1963-64 financial year proved to be too slow an instrument to make his own experiment a successful one, as Robert Hall observed. Alfred Marshall, Principles of Economics, 1890. Robert Hall, "Incomes Policy - State of Play", Three Banks Review, March 1964. Samuel Brittan, Steering the Economy: The Role of the Treasury, Harmondsworth: Penguin books, 1971, p. 275.
63 "[the participating countries] are willing to establish an institutional framework able to pursue monetary cooperation in Europe and help the Contracting Parties execute the decisions of the European Organisation for Economic Co-operation [...]" European Monetary Agreement, Preamble, Paris, 5 August 1955.
64 Harold James, International Monetary Co-operation since Bretton Woods, Oxford: Oxford University Press, 1996.
2.1. Inflation and the full employment target in the UK

Different countries gave different answers to this problem. The UK’s policy was reasonably coherent despite the decade being split between Tory and Labour cabinets: a strenuous defence of sterling, especially in terms of public image, and loyalty to Breton Woods. However, the British attachment to Breton Woods was limited by the higher importance attributed to it by the US: for the chairman of the Federal Reserve, McChesney Martin, sterling was “a first line of defence” against speculation. Privately, both within government circles and in the partisan research centres, studies were carried out on the possibility of switching, if not to a “Robot”-type scenario, at least to more flexibility for the existing system. This tendency came out as a by-product of the shift towards a different type of policy planning brought into economic policymaking by the so-called “Brighton Revolution”, led by the FBI and especially Sir Hugh Weeks during 1960 and 1961. The shift had implied a termination of the “Stop and Go” doctrine in favour of a longer term approach which emphasized growth as opposed to full employment as the main policy objective, and was also being supported internationally by OECD. It is in this context that the first British application to the EEC was filed. Meanwhile, the perspective of a North Atlantic Free Trade Area (NAFTA) was also discussed, especially within the Conservative Research Department. The balance of payments troubles that were becoming larger and larger were progressively making it clear that a solution would be required sooner rather than later. The UK needed a boost in its current account if it wanted to continue to afford the capital outflows that were implied by both its Sterling Area role and the loyalty to Breton Woods. At the same time, the country had to cope with rising unemployment: ironically, this showed that moving out of “Stop and Go” did not grant Britain any freedom from the Keynesian “tightrope” described by Chrystal, even if at this stage economic policy had experienced a definite shift out of Keynesianism, as Matthews and Dow observed. On the one hand it was still true that, to borrow Tomlinson’s words, “monetary policy for most of the post-war period [was] clearly secondary to fiscal policy”, the reason being that “by 1945 the left had developed a great mistrust of monetary means of regulating the economy”, and at the same time, general

64 Matthews’s point was that budget deficits did not actually generate full employment. Indeed, even if - before the 1971 record of 3.3% - unemployment rates had always shown figures below 3%, the author argued that this was not a direct consequence of the budgetary policies pursued by the Treasury, and that it would be rather due to private sector determinants such as private investment and exports. Robin C.O. Matthews, “Why has Britain had full employment since the war?”, Economic Journal, 78/3, 1968.
66 Dow pointed out that the focus on budgetary deficits cannot be derived from Keynes’s General Theory, even if Tomlinson counter-argued that in some of Keynes’s minor works it is clearly possible to find a concern about the fact that budgetary deficit would become the direct consequence of the application of his policy proposals. J. Christopher R. Dow, The Management of the British Economy 1945-60, Cambridge, 1964.
68 According to the author, this was due to theoretical reasons stemming from the fact that “the use of monetary instruments has tended to be linked to priority being given to defeating inflation, rather than reducing unemployment, again contrary to the left’s usual priorities.” Tomlinson, “British economic
disillusionment on monetary policy was also widespread among the Tories.\textsuperscript{76} But on the other hand, as the years went on, even if macro-economic policy invariably assumed a strong fiscal policy emphasis, monetary policy gained more and more importance as it was meant to be employed in keeping the value of the pound, therefore being given more weight than fiscal policy.

The interaction of different policy choices in creating an overall picture was complex. Tomlinson suggested that macroeconomic policy comprised a set of four main objectives\textsuperscript{77} - full employment, containment of inflation, equilibrium in the balance of payments, and economic growth - of which in general a government is only able to pursue one or two.\textsuperscript{78}

In the UK, policy-makers had focused on full employment since the war,\textsuperscript{79} mainly due to the Keynesian theory’s influence over British policy-making, in particular as regards the role of budget expansion in bringing about full employment and economic growth through the public deficit lever.\textsuperscript{80} Later on, the wartime experience was almost translated into the conviction that peacetime control over production would have brought about the same anti-inflationary benefits.\textsuperscript{81} At any rate, these views cannot explain the whole point of having a full employment goal in post-war UK. As Smith correctly pointed out\textsuperscript{82} - despite acknowledging that “British economic policy can be seen as quite definitely Keynesian”\textsuperscript{83} - the policy directed towards a full employment goal was not the only possible Keynesian solution for post-war Britain, recalling Kaldor’s work which proposed that a viable Keynesian solution might have been pursued through an exchange rate policy, directing budgetary policy to the pursuit of output and exports, as well as setting up a balance of payments target.\textsuperscript{84} Smith’s conclusion was that a “Keynesian” policy does not refer necessarily to a specific policy instrument; rather, “The legitimate area includes the whole realm of demand management (which may extend further than the budgetary aggregates)”.\textsuperscript{85} As was pointed out in the previous section, even Maudling and the Tories made large use of that “demand management” in the broader sense. Despite such unemployment-reducing policy orientation, Britain’s employment track record deteriorated during the 1960s, together with rising inflation; as a consequence, price stability became the second most important policy objective.

Yet, such prioritization did not include the balance of payments. The problem was that the balance of payments was no longer negligible, and the idea that inflation might be coming from abroad reinforced the views of those who, like the supporters of Robot in the 1950s, pushed for a solution to the problem that should include a reform of the Bretton Woods system.

2.2. “Dirigismo”, inflation, and the balance of payments crisis in Italy

In terms of economic policy debates, Italy too was struggling with practical as well as theoretical uncertainty. Since Tomlinson’s framework has subsequently been adopted by a number of British monetary historians, it may be useful to take inspiration from it and adjust it to Italy. At first sight, the main difference between that analysis and the Italian case is that, the main variables being roughly similar, their ranking is certainly different. Italy’s traditional policy objective was price stability, hence the prominent attention paid to inflation, which clearly represented the unwanted disruption of such an

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\textsuperscript{79} Roger Middleton, The British Economy Since 1945, London, 2000. This was already evident as early as 1940: in a memorandum with the eloquent title “Internal Measures for the Prevention of General Unemployment”, the government’s Central Economic Information Service suggested the application of policies directed to the control of production, the expansion of budget and therefore the goals of full employment and, as a corollary, inflation control; which is to say, Keynesian policies. TNA CAB 87/4, JIP 41(3), 3 November 1940.


\textsuperscript{81} K. Smith, “Why was there never a Keynesian revolution in economic policy? A comment”, Economy and Society, 11/2, 1982.

\textsuperscript{82} Ibid.


\textsuperscript{84} K. Smith, “Why was there never a Keynesian revolution in economic policy? A comment”, Economy and Society, 11/2, 1982.
objective from the early 1960s. During the same years, the domestic economy was entering a new phase, represented by the fading away of the catch-up effect on the other European economies, which opened the way to a debate on modernization and on the pursuit, or the maintenance, of economic growth, an objective that proved to be on top of Governor Carli’s priority list.  

In the early post-war years, the economic boom fostered both production and consumption, keeping both exports and imports at high levels. However, thanks to a slightly lower cost of labour, the exports figures had always been larger than those of imports, a situation which maintained the trade balance - and as a consequence, the current account - in surplus. By 1962, the cost of labour throughout Western Europe was very advanced in its process of convergence, which jeopardized Italy’s export advantage.  

The problem with such a change was that, meanwhile, consumption was still rising, and therefore imports were rising too. This translated into a trade balance, and in turn a current account, deficit. Between 1962 and 1963, more than 1.2 billion dollars had to be borrowed by Italian banks in order to compensate for such a deficit.  

Moreover, trade unions had started to fight for higher nominal wages which increased production costs - making Italy’s production less competitive - and boosted prices, by generating an add-up to inflation that eventually left the working class worse off. Economic planning was the answer of the early 1960s governments, whose colour had meanwhile changed from the right to the left within the Christian Democratic party. Aldo Moro, Mariano Rumor and Emilio Colombo’s governments, from 1962 to 1970, were oriented towards a mixture of economic planning and dialogue with the trade unions. On the one hand, the former can be said to have at least potentially worked through the creation, by Budget Minister Ugo La Malfa, of a National Committee for Economic Planning, aimed at supporting the government in the implementation of five-year economic plans, the first of which was adopted in 1965 and targeted a 5% annual growth through 1969.  

On the other hand, however, the relationship with trade unions, which deteriorated until the decade came to a close, has sometimes been read as the epiphenomenon of a latent class struggle. Especially since the emergence of stagflation, the use of all policy instruments was invoked in order to address it; this included the monetary lever which therefore, implicitly, put the stability of discount and exchange rates into question.

One must now take one step back and consider the process of policy formation, as sketched out at the beginning of this chapter, in order to assess where policy planning might fit into that picture. Indeed, Italian planning in the 1960s belonged to an attitude that was labelled dirigismo, a term which approximates to a “top down approach”. There was no universal agreement on the fact that such a paradigm represented the best solution: in 1967 the Central Director of the Bank of Italy, Franco Masera, pointed out that the adoption of economic planning as a paradigm for the whole economic policy would, in the best case, be a good idea in the short run, but under no circumstances could it be advisable, nor affordable, for Italy in the long run.

Masera also tackled the issue of capital movements. In the years between the balance of payments crisis of 1962-63 and the adoption of the first economic plan in 1965, exports had grown and brought the current account to a position of surplus. However, investments in fixed capital had fallen by 10% in 1964 and 8% in 1965, despite the investment:

81 To make the situation even more complex, post-war growth was atypical. Economist Bradford Delong claimed that post-war recovery in Western Europe can be exceptionally inserted into a larger historical “virtuous circle” of growth, rather than responding to the logic of business cycles. Judging from how different the structure of the Italian economy itself looked like between the pre-war and the post-war years, it seems that Delong’s explanation may hold: “[...] post-WWII western European economic policy was so successful because it tapped into a virtuous circle. Trade expansion drove growth, growth [led to social peace, which] allowed inflation to stay low even as output expanded rapidly, rapidly expanding output led to high investment, which further increased growth and created the preconditions for further expansions of international trade.” J. Bradford Delong, Post-WWII Western European Exceptionalism: The Economic Dimension, http://www.j-bradford-dejong.net/Econ_Articles/ica/aica/клаш_marshall2.html, 1997.
84 The rationale of the planning rested on what was a fundamentally Keynesian approach - increase public expenditure in order to raise demand in order to increase growth - but it had a bias in Italy, at that time, it would have been hard to offset the loss in productivity due to the increased cost of labour, as private savings were all but going towards financing production, due to a fiscal system which discouraged this practice. Moreover, planning was in contrast with the trade unionist goals of higher nominal wages as a means of redistributing wealth.
86 The “top” is meant to be the government, the “down” is the market, and the transmission belt should be the public sector. This attitude “had originated from two alternative ideological mindsets: the economic culture of Catholic origin, and the Marxist one”, Giorgio Basevi and Paolo Onofri, “Uno sguardo retrospettivo alla politica economica italiana negli anni Sessanta”, Economia Italiana, n.1/2, 1997, p. 222.
positive margins left by the mentioned current account surplus. As De Rosa observed,\textsuperscript{93} this phenomenon led some scholars of the time, such as Magnani in 1968, to think that the competitiveness of Italian prices did not depend on the changes in the cost of labour, but on the higher or lower targets in terms of profit levels.\textsuperscript{94} The claim was that Italian producers were giving up some of their possible profits in order to defend the exports level, and therefore the surplus was being sustained artificially instead of promoting structural modernization.

Certainly, therefore, it can be affirmed that the external balance - that is, a balance of payments target - also became a goal of economic policy in the early 1960s. As has been pointed out, indeed, the 1962-63 crisis had made it clear that the current account, which had supported Italy's balance of payments up to that stage, would not do so indefinitely, and therefore it was necessary either to act on that part of the balance or on its counterpart, that is, tackling the issue of capital flows. But the crisis also paved the way for another, possibly more intriguing question: would it not have been thinkable to solve all problems by simply letting the exchange rate adjust to market conditions?

2.3. The debated causes of inflation, and Guido Carli's influence

As in most other Western countries, Italian economic historiography also tackled, in retrospect, the question regarding the nature and the causes of inflation. Even though answers regarding its nature have been attempted, there still seems to be disagreement on the issue. On the one hand Basevi and Onofri suggested that until 1971 "The habit to the fixity of the exchange rate seem[ed] to protract excessively, even at the beginning of [the 1970s]: [...]. In such conditions, the Italian inflation rate was still mainly determined by world inflation."\textsuperscript{95} On the same issue, though, Fratianni and Spinelli suggest a different explanation, affirming that it was time to outline "the groundlessness of a common thesis [...] which attributes the Italian high inflation of the 1970s to factors that are mainly international in nature"; in order to contrast this view, the authors claimed the existence of "a strong correlation between domestic inflation and the inflation differential relative to the United States,"\textsuperscript{96} basing their argument on the empirical data that have been reproduced in Figure 4. The result is what the authors affirm: if the amount of foreign-driven inflation is the difference between the two trends, there had not been much of it in Italy in the 1960s.

\textbf{Figure 4. Similarity of the trends in domestic inflation and inflation differential relative to the United States in the years 1950-1980.}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{fig4.png}
\caption{Similarity of the trends in domestic inflation and inflation differential relative to the United States in the years 1950-1980.}
\end{figure}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{fig5.png}
\caption{Similarity of the trends in domestic inflation and inflation differential relative to the United States in the years 1950-1980.}
\end{figure}

An important element in this picture is that, since Guido Carli's advent to the Bank's governorship in 1960, these policy lines had started to change rather dramatically. Besides changing its public image - from Menichella's "discreet place" to a "crystal palace", in which the people responsible for monetary policies were constantly scrutinised by public opinion\textsuperscript{97} - the attitude of the establishment switched from a strict compliance with the government's choices to a more or less open criticism of it.\textsuperscript{98} In the annual report for 1965, the Governor complained that the government's choice of running budget deficits was in contrast with art. 81 of the Constitution.\textsuperscript{99} At the same time, the Bank developed a view regarding the role of anti-inflationary measures and incomes policy which would bring it to open clashes with the government throughout the 1960s and 1970s.

\begin{table}[h]
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\begin{tabular}{|c|c|}
\hline
\textbf{Column 1} & \textbf{Column 2} \\
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Data 1 & Data 2 \\
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\end{tabular}
\caption{Table of data for comparison.}
\end{table}

\textsuperscript{93} Luigui De Rosa, "Lo sviluppo economico dell'Italia dal dopoguerra a oggi", \textit{Economia Italiana}, no.3, 1997.


\textsuperscript{97} Ibid., p. 598.


\textsuperscript{99} Banca d'Italia, \textit{Relazione Annuale per il 1965}, p.224.
In particular, Governor Carli thought inflation was being brought about by rising production costs. He put the blame for inflation on trade unions, defended the discount rate level, and insisted that wage reduction would have restored economic growth without drawbacks. The unions, instead, looked at a shift in the interest rate policy as a possible solution, hence generating the two possible scenarios described in Figure 5.

Figure 5. The IS-LM model and the two ways to restore the equilibrium in Italy.

<table>
<thead>
<tr>
<th>IS</th>
<th>LM</th>
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In terms of the Mundell-Fleming framework - a Keynesian novelty emerged during these years - the Bank of Italy supported a restoration of the interest rate level through a shift in the money market (LM) curve, while the unions would rather suggest a restoration of the full employment level through a boost to the real economy (IS) curve.

On their side, the different governments - that were almost always represented by four-party coalitions throughout Carli’s governorship, including the entire time framework of the present research - struggled to elaborate strong responses to such developments. Indeed, one typical feature of the Italian cabinets was to be weak and short, especially considering that the Bank’s leadership was, by definition, much more stable. Carli himself was in charge for fifteen years until 1975, a period during which seventeen different cabinets had executive power. This feature led to monetary stability, according to some, or on the contrary, to a situation in which the Bank too often read its mandate as allowing it to strenuously defend the vested interests of certain firms and banks.102

Of course, the position on these issues was sometimes determined by elements other than pure economics, such as political opportunity, or mere path dependency. However, the economic developments in policy-making, that have just been sketched, must not be underestimated in their potential to change some key perspectives. Indeed, among the unintended effects of an uncontrolled inflationary trend, one should also mention that Italy had maintained a fixed exchange rate since 1949. The fixity of this rate was correctly seen as the basis of the steady rise in competitiveness the country was experiencing. However, such rise in competitiveness did not only depend on the fixed exchange rate, but also on the relative price.103 When the latter started to rise, the former started to be questioned.

2.4 Harold Wilson’s first attempt at incomes policy, and his late Europeanism

A leftist governmental experience was also found in the UK at around the same time: Harold Wilson’s victory over the Tories in 1964 paved the way for two consecutive Labour cabinets whose focus was economic planning and a tentative dialogue with the trade unions, although the latter proved more and more difficult given the government’s intention to solve some of the economic problems through the adoption of an incomes policy, typically unacceptable to the trade union movement.104 The most relevant feature of the Wilson cabinets was the change of views, or at least of action, in two areas of policy that are very central to the present research: on the one hand the conversion to Europe of 1966, and on the other hand the devaluation of sterling in 1967. Put together, these two events represented a U-turn in terms of the British attitude

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102 Some would object that this is not due to disagreement or ineptitude, but it is simply a consequence of being a parliamentary democracy with a proportional electoral system. For instance, Giulio Andreotti, *Governo con la critta*, Milano: Rizzoli, 1991.
104 This is the impression one can get from personal conversations with some former officials at the Bank, who wish to remain anonymous, as well as the general judgement expressed in Franco Spinelli and Michele Fratiannei, *Storia monetaria d'Italia*, Milano, 1991.
105 Competitiveness is defined as the reverse of the real exchange rate, q = EP*P. In such definition, q depends on E but also on P/P*, that is the relative price, i.e. the ratio of domestic to foreign prices. The point that needs to be made here is that low domestic prices, P kept q at bay, which is to say, a higher competitiveness.
In particular, Governor Carli thought inflation was being brought about by rising production costs. He put the blame for inflation on trade unions, defended the discount rate level, and insisted that wage reduction would have restored economic growth without drawbacks. The unions, instead, looked at a shift in the interest rate policy as a possible solution, hence generating the two possible scenarios described in Figure 5.

![Figure 5. The IS-LM model and the two ways to restore the equilibrium in Italy.](image)

In terms of the Mundell-Fleming framework - a Keynesian novelty emerged during those years - the Bank of Italy supported a restoration of the interest rate level through a shift in the money market (LM) curve, while the unions would rather suggest a restoration of the full employment level through a boost to the real economy (IS) curve.

On their side, the different governments - that were almost always represented by four-party coalitions throughout Carli’s governorship, including the entire time framework of the present research - struggled to elaborate strong responses to such developments. Indeed, one typical feature of the Italian cabinets was to be weak and short, especially considering that the Bank’s leadership was, by definition, much more stable: Carli himself was in charge for fifteen years until 1975, a period during which seventeen different cabinets had executive power. This feature led to monetary stability, according to some, or on the contrary, to a situation in which the Bank too often read its mandate as allowing it to strenuously defend the vested interests of certain firms and banks.102

Of course, the position on these issues was sometimes determined by elements other than pure economics, such as political opportunity, or mere path dependency. However, the economic developments in policy-making, that have just been sketched, must not be underestimated in their potential to change some key perspectives. Indeed, among the unintended effects of an uncontrolled inflationary trend, one should also mention that Italy had maintained a fixed exchange rate since 1949. The fixity of this rate was correctly seen as the basis of the steady rise in competitiveness the country was experiencing. However, such rise in competitiveness did not only depend on the fixed exchange rate, but also on the relative price.103 When the latter started to rise, the former started to be questioned.

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105 Competitiveness is defined as the, reverse of the real exchange rate, \( \frac{E}{P^P} \). In such definition, \( E \) depends on \( P \) but also on \( P^P \), that is the relative price, i.e. the ratio of domestic to foreign prices. The point that needs to be made here is that low domestic prices, \( P \) kept \( q \) at bay, which is to say, a higher competitiveness.


towards international monetary policy: the former implied a possible acceptance of the idea that Europe set the monetary framework in the near future, and the latter provided a signal to the rest of the world, and in particular to the Sterling Area, that the prestige of sterling was no longer a priority for the UK and that therefore, implicitly, Bretton Woods might not continue to exist for long.

Up to that stage, devaluation had been "delayed well beyond the point of maximum advantage [...] until after heavy forward sales of sterling had been made [...] ministers were unwilling to contemplate action that would have the advantage of surprise." According to Wyn Grant, this strenuous defence of the sterling parity was due to the fact that it was only in 1967 that it became clear that Britain would not be allowed to enter the EEC unless sterling was devalued. Moreover, talks about incomes policy - as emerged after the "Brighton revolution" and the subsequent fight on "Stop and Go" - had raised the issue of Britain's competitiveness: Macmillan claimed the only way to defend competitiveness would be wage control, and Wilson was eventually convinced to try a very similar course of action. The alternative to incomes policies would be, obviously, devaluation: in this sense the defence of sterling and the wage level came to be seen as a trade-off.

Many of the side effects, that have just been defined as the Pandora's box of the Bretton Woods system for Italy, ended up creating a similar reaction to the deterioration of British competitiveness. This took place in the same years, and was even fostered by the perception of "decline" which has been widely described earlier in this chapter. However, there was a remarkable distinction between the role of the Italian lira and that of the British pound in the Bretton Woods system, the latter currency being the second claim reserve currency, to which the Sterling Area economies had anchored their own national currencies. Under a British perspective, to question Bretton Woods in the mid-1960s was tantamount to abandoning such international role, a stance which opened a big question mark as to what the subsequent international order would have looked like, and where Britain would have stood in its context. It goes without saying that answers were not provided, nor did most of the actors involved in these policy choices have enough instruments to assess the situation correctly.

3. MODERNIZATION OR DECLINE, GROWTH OR STAGNATION, SUBJUGATION OR REVOLT? (1967-70)

Coming back to Tomlinson's analytical framework, it must be noted that full employment and inflation were not the only guidelines of British macroeconomic policy. Another undeniable elephant in the room in the late 1960s came to be the balance of payments, which, in an imaginary British monetary thesis of the post-Second World War era, was interchangeable with "value of the pound". As a matter of fact, from the birth of the Bretton Woods system in 1944 until the floating of the pound in 1972 as a consequence of its demise, the attention policy-makers paid to the balance of payments was strictly connected to the defence of a particular exchange rate against the dollar.

3.1. The 1967 devaluation of the pound

To defend the exchange rate implied an everlasting struggle to strengthen the official reserves, in order to induce confidence and hedge against possible runs on the currency. Eventually, the trade-off between sticking to Bretton Woods and facing a balance of payments disequilibrium leading to potentially disruptive speculations became unsustainable. After strenuously defending the sterling parity of $2.40, on 17 November 1967 the Wilson government eventually decided to devalue the national currency to $2.40. The impact of this event on British monetary policy was comparable to an earthquake. On the one hand, it was a long term change. Not only did it upset the Americans who had earlier sent their monetary Under-Secretary of State, Roosa, to try

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111 This value, at the beginning $4.03, ended up being reduced twice - in 1949 and in 1967 - until the level of $2.40.
to convince Callaghan, at the time Chancellor of the Exchequer, not to devalue.\textsuperscript{112} even more, by agreeing to devalue, the government abandoned the idea that the British currency retained a role in, and therefore was responsible for, the stability of the international system.\textsuperscript{113} On the other hand, a shorter term shift was to be recorded: the Wilson cabinet had already questioned the feasibility of a devaluation in 1964 but since that time, after deciding it would not have been the appropriate choice, it remained firm on the defence of the parity for the years to follow, until this new decision to float.

As has been already pointed out, the meaning of a devaluation in a FBAR regime is important: what prevents the markets from thinking it is not going to be a one-off action? What historiography has perhaps not taken into sufficient account is that the 1967 decision was not a one-off choice. The devaluation had an aftermath, which may be defined as the period from this event until the breakdown of Bretton Woods in 1971.\textsuperscript{114} The main features of this period, in terms of monetary policy-making, were two: one was that the behaviour of the British trade balance did not follow the predictions of policy-makers, hence putting them into difficulties;\textsuperscript{115} the other was that a debate was continuously brought forward as to what monetary regime would be best for the United Kingdom.\textsuperscript{116} After devaluing the pound, then, British policy-makers never thought, nor were they allowed to think, that a one-off devaluation would adjust all problems: rather, a continuous research activity on possible contingency plans was carried out, as recent literature from newly released primary sources has extensively shown.\textsuperscript{117}

Interestingly, this debate was not only developed inside the Bank of England and the British Treasury: other actors had a say, or wished to have a say, too. In this context, and due to the particular position in which it was during these years, the trade union movement in Britain played an especially active role.

By January 1968 it had become clear that devaluation had failed to bring about a slow-down in imports; rather, imports kept growing due to the increased consumption that had in turn been fostered by the export sector, in which British commodities looked cheaper to foreign customers. The trade balance then remained negative, bringing the whole balance of payments down.\textsuperscript{118} As a consequence, since December the exchange rate of the British pound was constantly hitting $2.38, the lowest margin of the range allowed by the Bretton Woods pegging rule.\textsuperscript{119} In this situation, the Bank of England was forced to sell dollars from its own reserves in order to defend the parity. For the record, this was the beginning of the reserve drain that would lead, in a mere three months, to the gold crisis of March 1968,\textsuperscript{120} perhaps the most dangerous of the post-war era and the one which, as Oliver and Hamilton pointed out, marked the adoption of full-scale contingency planning by the Wilson government,\textsuperscript{121} a practice which became the norm at least until the demise of the Bretton Woods system.

In order to cope with the situation, the government launched a plan which should have cut expenditure by some £700 million during the financial year.\textsuperscript{122} This anti-Keynesian measure was a sort of alternative to the possible Keynesian solution of letting the deficit go - in the hope that it would end up fostering the export sector towards a rebalance of the economy - or the alternative to raise taxation in order to calm home demand without cutting public expenditure.\textsuperscript{123} The former was not feasible at the time: this was due to either the effective danger of a speculative attack on the pound if the balance of payments had further deteriorated, as was commonly feared by both Bank


\textsuperscript{119} Alec Cairncross, 	extit{Managing the British Economy in the 1960s, Basingstoke: Macmillan}, 1996.

\textsuperscript{120} Michael J. Oliver and Arran Hamilton, "Downhill from devaluation: The battle for sterling, 1968-72", 	extit{Economic History Review}, 2006.

\textsuperscript{121} Alec Cairncross, 	extit{Managing the British Economy in the 1960s, Basingstoke: Macmillan}, 1996, p.203.

\textsuperscript{122} In terms of economic theory, the fundamental equation being \( Y = C + I + G + CA \), in front of a CA-/EXIM deficit, the government's solution was to reduce \( G \) in order to calm down \( Y \) and, conversely, contain \( IM \). The Keynesian solution would have prescribed \(+G \) in order to foster \( Y \) and conversely the EX part of the CA equation. An alternative to both solutions might have been to raise taxation in order to calm down \( G \), and therefore \( IM \), without reducing \( G \); however, raising taxes is a notoriously unpopular choice.
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\(^{120}\) Alec Cairncross, Managing the British Economy in the 1960s, Basingstoke: Macmillan, 1996.


\(^{123}\) In terms of economic theory, the fundamental equation being \(Y = C + G + X - M\), if the government’s solution was to reduce \(G\) in order to calm down \(Y\) and, conversely, contain \(M\), the Keynesian solution would have prescribed \(+G\) in order to foster \(Y\) and conversely the \(EX\) part of the \(CA\) equation. An alternative to both solutions might have been to raise taxation in order to calm down \(C\), and therefore \(IM\), without reducing \(G\); however, raising taxes is a notoriously unpopular choice.
and Treasury,\textsuperscript{124} or at least to the fact that the mainstream economic view was that the paramount objective of economic policy should be the balance of payments,\textsuperscript{125} the reason for this position having been extensively pointed out by Tomlinson,\textsuperscript{126} and criticized by Brittan in his early essays.\textsuperscript{127}

The policy package adopted by Roy Jenkins in 1968 ended up cutting public expenditure, and the official governmental view remained that neither floating the pound, nor undertaking action that might have led to it, would have been considered in the foreseeable future. However, recent research carried out by Oliver and Hamilton showed that the situation was evolving quickly, and the government itself had already undertaken secret studies on possible contingency plans aimed at finding solutions to the monetary problem; while the initial Operation Brutus did not consider the possibility of floating, the immediately following Hecuba and Priam plans made provisions for this event, in case the international situation unfolded in a certain way.\textsuperscript{128} While the unions were showing increasing support for the Special Drawing Rights scheme, then, the Treasury was developing Operation Brutus, a contingency plan envisaging the blocking of sterling balances in order to stop the drain of dollars from the United Kingdom’s reserves.\textsuperscript{129}

Oliver and Hamilton pointed out that the Bank of England was not keen on such plan, as “it would be the accounts of its customers that would be blocked.” Moreover, “blocking would undermine the position of the City of London. It would close the door on the inflow of foreign capital to London and undermine the sustainability of the UK’s investment banks.”\textsuperscript{130} The authors move on by affirming that the Bank suggested floating as an alternative, but such measure would not have been acceptable at the time, and the situation was solved by the extension of a US and G-10 facility of $4,050 million to protect the pound and then, later on, by the United Kingdom’s participation to the Basle Agreement, which would provide the country with “swap facilities to offset most of any reduction in their reserves caused by fluctuations in sterling held both publicly and privately overseas”.\textsuperscript{131} Blackaby’s comment on the agreement is that it “effectively removed one threat to sterling”.\textsuperscript{132} However, the effect of the Basle Agreement was to suggest that, in case Operation Brutus had to be put in place and failed, floating would have become the inevitable alternative. As a consequence, two new contingency plans were worked out during the summer of 1968, the mentioned Operation Hecuba and Operation Priam, both prescribing a floating of the pound, the difference between them being the domestic or foreign cause of a possible crisis.\textsuperscript{133}

\subsection*{3.2. Monetary policy, trade deficit and economic planning in Italy}

Meanwhile, uncertainties about the changing economic situation were also spreading in Italy. During 1967 and 1968 the domestic monetary base had kept rising in line with the trade balance surplus, and the mentioned government policies of 1968 created inflation on top of this already existing expansion, while the strikes during the same year raised the cost of labour.

On top of that, the rise in the monetary base had to be directed towards the coverage of the budget deficit generated by the higher public expenditure (pensions and public sector wages), which in turn limited the lending capacity of the banking sector. Unfortunately, lacking developed financial markets, the country’s private industry was mostly dependent on bank lending.

Even so, the monetary policies pursued seemed to make sense at the time. The way monetary variables were measured also intervened in this debate. During the 1960s, the concept of the monetary base was introduced, and many new theories shed new light on the analysis of monetary policies. In particular, Brunner and Meltzer’s study on monetary aggregates - namely the non-linear money supply hypothesis\textsuperscript{134} - had an

\begin{thebibliography}{99}
\bibitem{129} Ibid., p. 5.
\bibitem{130} Ibid., p. 5 (emphasis in original).
\bibitem{131} Ibid., p. 7.
\bibitem{134} Karl Brunner and Allan H. Meltzer, \textit{An Alternative Approach to the Monetary Mechanism}, 1964.
\end{thebibliography}
influence on Antonio Fazio, at the time a Bank official, who was in charge of building a model based on that, and came out with something very similar to the one developed by the two American scholars. The basic feature of Fazio’s model was that the analysis of the interaction of five money markets showed that discount and interest rates moved in the same direction. The problem with this view is that, while it certainly applies to a closed economy, it would not work in an economy in which capital can flow in and out depending on the relationship between domestic and foreign rates. Spinelli and Fratianni also report the influence of Modigliani’s claim about the scarce relationship between real economy and monetary sector, a concept very popular in those years due to the monetarist debate.

If capital was supposed to help the balance of payments, timing was also unfortunate: by the end of the decade it became clear that higher capital mobility was in fact going in one single direction - that is, letting capital flow out of Italy - and at the same time exports kept falling, which was contrary to the reason why free capital movements were believed to be temporarily good for the country. The monetary authorities started to realize that the outflow was connected to the existence of better investment opportunities abroad and to the general belief that the “Italian miracle” was over.

The debate became particularly pressing during the years immediately preceding 1969, when the discount rate fixity pledge made by the Governor started to come under increasing pressure. But rather than Fazio’s model, the underlying reason was probably that an important actor did not wish to see the cost of its debt rise, as “[...] modifications in the preference for liquidity on their side provoke variations in bond prices which, though being easily negotiable, are not entirely liquid [and] represent larger and larger percentages of the nation’s wealth, [...]”.

All in all, with stable rates and freer capital movements, the role of monetary policy was clearly limited, and specifically it had to second the needs of the balance of payments. In the first Annual Report of his governorship, Carli had already made it clear that “[...] the monetary policy instruments, that it will be judged appropriate to adopt, will be applied with total diligence, especially paying attention to their effects on the balance of payments”, that is, the external prescription of the Mundell-Fleming policy mix.

Meanwhile, the international situation seemed to unfold in a way that possibly made the concerns over Bretton Woods more and more pressing: the Vietnam War started by the Kennedy administration, and continued by Johnson and Nixon, proved to be a source of deficit for the American budget, a deficit which was not addressed domestically and that therefore spilled over to the rest of the monetary system through the fixed exchange rates system.

Moreover, Italy’s trade balance was to plunge below zero again in 1970: a phenomenon due, according to the Bank of Italy, to “the disequilibrium between domestic demand and supply”. In the annual report for 1970, the Bank considered that the trade balance was still sustained by a surplus in services and capital income, as well as by the other side of the balance of payments, as the capital outflows of 1969 had been reduced substantially. This better result was due to the concerted action of the fall in foreign interest rates and the decision of the Bank to finally raise the discount rate.

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136 The five money markets were monetary base, bank deposits, bank deposits with limited accessibility, bank lending, and bonds. As a consequence of a cut in the discount rate, the monetary base rose, thus leading to larger bank reserves, in turn leading to a rise in demand for bank lending at a lower interest rate. Franco Spinelli and Michele Fratianni, Storia monetaria d’Italia, Milano, 1991.

137 This point is quite relevant if one thinks that Fazio’s model was the theoretical basis for the Bank’s defence of the discount rate fixity that was to last for eleven years until 1969, while monetary expansion was pursued through alternative channels such as the modification of bank reserve requirements, and the balance of payments was very much affected by capital inflows and outflows which ended up changing the predicted effects of such model.

4. THE CASES FOR FLEXIBLE EXCHANGE RATES IN THE LATE 1960S

The international projection of the situation described so far was, unsurprisingly, the result of the sum of the domestic concerns expressed by the countries taking part in the Bretton Woods system. A widespread feeling pointed at the persistent US deficit, paid for through seignorage, as the main cause of trouble; however correct this belief might have been - and it was certainly correct to a certain extent - its being held as the main scapegoat generated unrest. The answers considered in the late years of the 1960s were at times unilateral - as was the case of the British sterling devaluation that has been described earlier - and at times multilateral, such as the Special Drawing Rights scheme that was implemented in 1968, as well as the “two tier” gold market that followed.144

Other measures were oriented towards a limited multilateralism, such as the ideas for monetary integration that had started to circulate within the EEC; such plans, despite not being openly in competition with Breton Woods at this stage,145 certainly addressed the concerns of several European countries, which felt endangered by the possible demise of the worldwide FBAR. In this light, talks about alternatives to the formation of an EEC monetary bloc were secretly held within the British policy-making core, with the most likely possible alternative to the EEC being the already mentioned North Atlantic Free Trade Area with a monetary corollary, which was looked at as the ultimate way of ensuring exchange rate stability with the American ally.146

But it did not take long for the cases for exchange rate flexibility to be once again in the limelight of international politics. Robert Triffin, in a 1969 review of his “paradox”, made a strong case for exchange rate flexibility.147 In this he joined American economist Gottfried von Haberler, who in the same years was expressing very similar doubts on fixed exchange rates.148

Adding up to the international debate, the domestic debates in the two countries considered in this thesis were to some extent driven by international events. However, they also showed features specific to the institutional, political, academic scenario of the national communities they emerged from, as will be pointed out in more detail during the two case studies.

The greatest "home" supporter of flexibility was Samuel Brittan, who spoke extensively of the need for such a reform of the regime, so that rates could be used in order to address balance of payments imbalances, as opposed to using monetary or fiscal policy to defend the external balance, thereby neglecting the other domestic concerns which those years certainly did not lack.149 The UK government undertook in 1968 a "flexibility exercise" upon whose importance the literature has not agreed: Margaret Vries Garretson,150 John Odell,151 Robert Solomon152 talk extensively about it.

144 Ibid., p. 151.
Paul Volcker,\textsuperscript{153} Harold James,\textsuperscript{154} Charles Coombs\textsuperscript{155} devote a few pages to it, while the event is completely absent in Strange\textsuperscript{156} and Eichengreen.\textsuperscript{157}

Italy, too, was not in the position of light-heartedly accepting the situation: in general terms, the country was left at the end of 1969 with high inflation; a higher cost of labour as well as more limited availability of bank lending, both of which created a loss in productivity; and a balance of payments deficit. All in all, this was not really a good result in terms of policy planning. In this light, governor Carli - possibly the only high level policy-maker who could afford to make such claim - started to insert the expression "international monetary reform", meaning broader fluctuation bands, into his own narrative.\textsuperscript{158}

4.1. Europe as an exchange rate stabilizer

The counter-argument to all supporters of floating rates was, again, the obvious advantage that a stable exchange rate represented for foreign trade. A closer look at trade patterns, however, revealed that for certain groups of countries most foreign trade was conducted with neighbours. It is in this picture that the idea of building a closer monetary partnership within the recently born EEC started to take shape.\textsuperscript{159} Indeed, exchange rate flexibility was not necessarily incompatible with regional agreements for monetary cooperation. The obvious candidate for such an agreement was the EEC, which had included the commitment to "the co-ordination of the policies of Member States in monetary matters" in its founding treaty\textsuperscript{160} and whose internal market objective was benefiting from the stability of exchange rates provided by Breton Woods. In 1968 it was Robert Mundell himself who advanced the theory of "Optimum Currency Areas", in which he analyzed whether the EEC would be one of such areas, concluding that it was not the case, due to the lack of labour mobility that would have opened the way to asymmetrical shocks between countries.\textsuperscript{161}

Despite being aware of these problems, European policy-makers were faced with all sorts of different considerations while assessing whether it would have been a good idea to proceed with the ideas of monetary unification that had existed since the very creation of the EEC back in 1957, that had been preceded by the EMA. Indeed, Mundell's criticism based on labour mobility grounds had a strong counterfactual: the risk of asymmetrical shocks had to be measured in the light of the cost of not creating closer monetary ties and then finding oneself with savage exchange rate floating hindering trade within the EEC in case the Breton Woods system would come to a sudden breakdown. Policy-makers advocating monetary unification - such as Raymond Barre\textsuperscript{162} and Pierre Werner\textsuperscript{163} - had this counterfactual very clear in mind, as much as they also knew the limitations of Ruff's as well as von Haberler's theories. Instead, they looked at Triffin's curse and his exchange rates flexibility solution as a possibility for the world at large, while at the same time promoting the idea that currencies should be fixed within the EEC area.

Meanwhile, as a consequence of the evident trouble that Keynesian economics was undergoing during the 1960s, new paradigms emerged which claimed that certain tenets of this mainstream view were to be given up. In particular, as has been pointed out, the Chicago School captured by Milton Friedman started to advance the view that

\textsuperscript{154} Harold James, International Monetary Co-operation since Bretton Woods, Oxford: Oxford University Press, 1996.
\textsuperscript{158} Banca d'Italia, Relazione Annuale per il 1968.
\textsuperscript{159} Wyn Grant, Economic Policy in Britain, Basingstoke: Palgrave, 2002, p. 103.
\textsuperscript{160} Treaty of Rome, Article 105.2, 25 March 1957.
\textsuperscript{161} Labour supply in excess in any European country could no longer have been offset by that country's use of monetary policy but, at the same time, labour would not have moved quickly enough from one country to another in order to solve the problem in this way. Robert Mundell, "A Theory of Optimum Currency Areas", in The American Economic Review, LII/4, November 1961, pp. 509-517.
\textsuperscript{162} European Commission, Mémorandum sur la coordination des politiques économiques et sur la coopération monétaire au sein de la Communauté, 12 February 1969.
\textsuperscript{163} Pierre Werner, Rapport au Conseil et à la Commission concernant la réalisation par étapes de l'Union économique et monétaire, European Parliament, 8 October 1970.
monetary variables had to be looked at with more attention than real variables, with the consequence that a crisis of production could be addressed by monetary adjustments as opposed to Keynesian demand management. Such a view assumed that in a world of progressively looser capital controls, fixed exchange rates were constraining monetary policy: hence, the monetarists reinforced the case for floating rates.

4.2. EEC, complement or alternative? One-world currency or monetary blocs?

To sum up the ideas forming the debate relevant to this research as of 1970, two main themes may be outlined. The former was the idea of giving up the Bretton Woods parities system, an opinion sometimes sustained by reflections on trade relations, some other times sustained by the willingness to solve the inflation export problem. The latter debate was about European monetary integration, which was much more complicated as many different underlying reasons converged in promoting its implementation. The foremost driver was that monetary integration was seen as a further step towards a more general integration with natural trade partners, as was claimed by movenents such as Jean Monnet’s “United States of Europe” initiative, which had prominent British and Italian politicians among its main supporters.

A trade argument being at the core of both themes, a possibly appealing solution was to reform the system in a way that would maintain the British and Italian exchange rates stable with regard to those countries with which they traded the most. Italy’s main trade partners were, notably, Germany and France; during the post-war decades, the UK too experienced a trade shift out of the Commonwealth and towards the EEC and EFTA areas. Hence, a monetary area superimposed on the existing common market started to be seen as the quintessential solution to the monetary puzzle.

Moreover, there was a growing perception that the price of exchange rates fixity outran its actual benefits. In particular, inflation was considered by some - especially

French President De Gaulle and Jacques Rueff - as a disease that the United States was creating, and that Bretton Woods was making contagious. Besides the trade argument, then, some started to consider the promotion of international financial integration in a way that would help budget deficits finance themselves “through long term capital inflows, rather than losing reserves, resorting to short term capital movements, or to compensation loans.”

This would have implied a higher dependency on the conditions of international markets. The problem of the reserve drain was all the more visible in the UK, which had a constant demand of capital export in order to finance the growth - and therefore the reserves - of the Sterling Area countries. This feature also prevented the UK from choosing to use the capital account in order to restore a balance of payments target. In a fixed exchange rates system, in order to avoid the event of official reserves running down, a country must balance its current account imbalances with a corresponding private net capital imbalance of opposite sign. This translates into a simpler statement: capital outflows must not be larger than allowed by the current account surplus.

However, to link the current account with the capital needs expressed by the Sterling Area countries was all but politically easy, especially in a country whose current account deficit would often require a capital account surplus, i.e. capital inflows, as opposed to sterling balances flowing into foreign countries’ reserves.

In the case of Italy, a solution might have been to develop the domestic money market in a way similar to the “operation twist” attempted by US Treasury Under-Secretary Robert Roosa during the Kennedy years, that is to say, a restructuring of public debt according to different time horizons. The goal for Italy might have been to be able to steer the trend of short-term interest rates towards the external balance target, thus keeping them high in order to create a surplus, and the trend of medium-term rates in the opposite direction. The problem was that in the case of Italy, there was not really a market for short-term debt.

References:
A third way out, which was actually attempted in Italy, was the continuous sterilization of the monetary base in order to match the ups and downs of the balance of payments. However, as Basevi and Onofri correctly mention with regard to the Mundell-Fleming approach, one cannot take for granted that fiscal policy may be used freely in order to defend the internal balance. Especially in the late 1960s, indeed, fiscal policy was a function of a bargain between government and trade unions.130

The situation in the UK was similar, especially given the social expectations the public had from Harold Wilson’s cabinet: the 1969 attempt at an incomes policy proved to be fatal to the cabinet itself. Without control on wages, however, the monetary policy freedom required for a stabilization was not thinkable in a fixed exchange rates world.

But the “princess” of ways out was of course a more ultimate move, which, as has been pointed out, was taken into consideration by the British monetary authorities several times during the post-war decades: to abandon fixed exchange rates, so as to contain the competitiveness problems created by a rate of domestic inflation higher than abroad, and at the same time to stop capital outflows through the appreciation of the exchange rate rather than through an upward adjustment to interest rates. Even though in Italy the support for such a move only started to spread around 1968 - beginning from the central bank - yet it stemmed from the same reasons: indeed, these same motivations are the core of Basevi and Onofri’s description of the main driver of the ideas of flexible rates. The same might apply if the hypothesis brought forward by Fratianni and Spinelli had been right: floating rates would have offset the foreign trade disadvantage of domestic-driven inflation.

For sure, at any point in post-war history, the economic rationale for floating rates had to cope with the political heresy that such an idea represented. Nor is it possible to affirm that such support was in place merely on the basis of the existence of economic grounds for floating rates.131 However, it is easy to think that the theoretical case for floating rates probably contributed to alleviate any sense of guilt when the time came to acknowledge the demise of Bretton Woods, as the following chapters will outline.

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131 At any rate, however, even this is no guarantee of adherence to the historical truth, as archival records are already notorious enough for being, themselves, quite good at concealing almost as much as they reveal. Rodney Lowe, "Plumbing New Depths? Contemporary historians and the Public Record Office", Twentieth Century British History, 8, 1997, pp. 463-91.

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CHAPTER 3

UK POLICY-MAKERS AND THEIR INTERACTION

I sum up the prospects for 1967 in three short sentences. We are back on course. The ship is picking up speed. The economy is moving. Every seaman knows the command at such a moment: “steady as she goes”.

-- James Callaghan, Budget Speech, March 1967

1. INTRODUCTION

Floating rates might have been consistently considered anathema by most theorists until the early 1960s;1 nevertheless, sometime between the late 1960s and the early 1970s, monetary disentanglement from the United States, as well as a new alignment with Europe replacing both the transatlantic ally and the former colonial relations transformed into the Commonwealth, came to be seen as Britain’s way forward.2 The consequences of this long-term shift of foreign economic policy are beyond doubt, if one looks at the British economy at the beginning of the first Wilson government and then again at the end of the last. The real question that still needs to be addressed by the literature on the UK is about its fundamental causes. In order to look for the causes, one must tackle a question about timing. Of course, each historical process is generated by a number of causes taking place at different times, yet history itself is also made of choices that work as turning points for certain events, and that are often concentrated during short “creative periods”.3 Usually, such choices and periods simply come to ratify an already existing tendency. Britain’s international role, including the monetary

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1 They preferred to claim the need for widening the fluctuation range. For example see Lawrence Krause on The Washington Post, 31 August 1971, and Erich Heinemann, “Economist Urges Currency Reform”, The New York Times, 26 August 1971.
responsibilities stemming from the country’s currency being used as official reserves by the members of the Sterling Area, had started to show signals of weakness as early as the 1950s, as has been pointed out in the introductory chapters. Doubts on the role of sterling - and, more generally, of the UK in the post-war setting - continued to grow while competitiveness came to clash with the sterling balances. Long-term shifts in trade patterns made the country grow closer to Europe than to the Commonwealth, and new social demands started to point their eyes towards the use of policy instruments in a more efficient way, in order to stop new and unknown problems such as stagflation. Even so, Britain during the 1950s and the 1960s ended up not taking ultimate steps, and even the 1967 devaluation came to be regarded as a one-off adjustment as opposed to a real change of direction in economic policy.

Hence, the thesis advanced here is that the United Kingdom’s “creative period” for monetary policy took place slightly later, namely during the months spanning Richard Nixon’s decision to close the gold window on 15 August 1971, to Edward Heath’s decision to let the British pound float on 22 June 1972. In this short time window, the US dollar officially abandoned the convertibility into gold, that was believed to underpin the entire world economy; the pound was floated for the first time; then Breton Woods was tentatively restored; and finally the pound floated against the US dollar again, this time for good. In the same window of time, the UK parliament approved the country’s accession to the EEC, the subsequent entry negotiations started, the “monetary snake” was launched, the UK took part in it, and the Sterling Area started to collapse.

Britain’s unique monetary position, and the most influential players

The positions regarding the international monetary regime in the case of the UK in the late 1960s can be traced back to four peculiar elements of the country’s position in


the post-war order. Incidentally, the same elements had made the British economy stand apart from the rest of Europe thus far: first, the international role that sterling maintained as a reserve currency in the Commonwealth,7 secondly, the subsequent “indebtedness” that stemmed from British capital being used in this official role within the Sterling Area,8 third the long-awaited British entry into the EEC, due in 1973 after three rounds of applications, an epochal change which seemed to imply joining the path towards a continental monetary union;9 and finally, the debate on the management of the domestic economy that many times had been addressed in terms of an alleged decline of the UK’s competitiveness relative to the rest of the world,10 a claim for which virtually all public institutions were blamed at some point in the early 1970s, the government itself being the most obvious scapegoat, but also both major parties, the trade unions and even the City of London.

Between Bank of England and Treasury, the Bank remained the most prominent player. Governor O’Brien was an advocate of monetary policy autonomy - as opposed to the mainstream Keynesianism that politicians of all colours seemed to appreciate during the 1960s - and he also supported disentanglement from the Sterling Area and involvement to the European monetary framework. Civil servants at Whitehall were caught between a rock and a hard place: would it have been better to follow the Bank and think that European monetary integration at all costs, including the demise of sterling’s international role, would make the country better-off by saving exchange rates fixity? Or would it have been better, on the contrary, to listen to the new Chancellor Barber and believe that a European monetary system would have been the solution to monetary problems without necessarily cutting off the possibility of a world system with a higher degree of exchange rate flexibility?11

11 This attempt at combining both goals is clearly visible from Barber’s stance on the entry negotiation as soon as he entered into office: talking of financial burdens, in 1970 he told the Sels that “I think it will be
The Tory victory of 1970: "away from demand management"

In June 1970, the general elections gave the Conservative party a parliamentary advantage of 30 seats. The new prime minister was Edward Heath and the new Chancellor Iain Macleod; the latter, who died on 20 July 1970, was then to be replaced by Anthony Barber, who would later give his name to the "Barber boom", a pseudo-Keynesian turn which is key in order to understand the scope of the policy change from 1972 onwards.

Labour left office after the six years of the two Wilson cabinets, after having proved unable to defend the sterling parity, and unable to stimulate growth with demand-side, Keynesian policies. Sterling had indeed been devalued in 1967, whereas the attempts to stimulate growth through demand pressure, embodied in the National Plan launched in 1965, resulted in an overheated economy - i.e. too much inflation and too little advantage from it - with consequent problems on both the par values and on the ability to control national macroeconomic objectives. Around these years, monetarists started to propose the idea that full employment might not be the only objective, when inflation and balance of payments troubles had made more and more evident that employment was not the only stabilizer for the economy. As is easy to imagine, in 1964 Wilson had found himself with a good policy package which would have worked in an ideal country, but not in the economically overheated Britain he had inherited from the previous Conservative era.

When Heath came to power in 1970, he thought the situation needed a concrete shift "away from demand management towards less interventionist supply-side policies" which, in his mind, would have stimulated growth, without the strong inflationary pressures that had led to the monetary troubles of the previous years. The theoretical framework of demand and supply side policies is shown in Figure 6.

generally agreed that the new decisions have for us made that problem of balance more severe... If I appear to labour this point, it is only because, unless such a solution is found, the burden on the United Kingdom could not be sustained and no British Government could contemplate joining." Quoted in Ron Leighton, The Labour Case Against Entry into The Common Market , Labour Committee for Safeguards on Common Market, September 1971. Britain and Europe since 1945, microfiche collection, Brighton: The Harvester Press, 1973, fiche 013.256, n.25.

The Bank of England's strength and weakness

In this picture, the Bank governed by O'Brien was not able to take strong stances other than responding to the government's decisions on a day-by-day basis, in order to stabilize the economy as much as possible. This weakness on the Bank's side seems to be its most striking feature throughout the 1960s and the first half of the 1970s. Reading the Bank's bulletins of these years, the impression is that central bank and government managed most monetary issues through a continuous adjustment of capital restrictions - a landmark being the announcement of the "Competition and Credit Control" approach in May 1971 whereas the discount rate was moved as a consequence of what the government's policy choices had been. The correlation between rates and flows during these years is summarized in Figure 7.

What is important to notice so far is that, in line with what has been said in Chapter 2 with regard to British macroeconomic policy, there was a bipartisan flavour in their implementation: eventually, both the Wilson and the Heath governments went to war with trade unions as a consequence of their inflation-oriented policy solutions. The Bank of England's strength and weakness

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14 In particular the Bank of England Quarterly Bulletin.
The main drivers of policy

In order to define the position - or the shift - of each significant actor in such a picture, it is useful to look at what drivers determined the policy options regarding the four issues introduced above. In particular, a shift from Bretton Woods to genuine European monetary integration would have meant taking action in one or more of these areas. This might have translated into, for instance, abandoning sterling’s reserve currency role, or phasing it out (thus reducing “indebtedness”); agreeing to dismantle the Sterling Area if deemed incompatible with the EEC; being in favour of accession to the EEC in general, and to Werner’s “monetary snake” specifically; holding that an EEC-based monetary area, with all its implications in terms of monetary stability but also of limitations to policy freedom, would propel rather than threaten the UK economy.

The positions regarding the reserve currency role and the Sterling Area were rather technical, and were therefore more in the domain of civil servants than of politicians; although, of course, references to them were also made in the political debate. Those on European integration and the domestic economy, on the contrary, were probably more a prerogative of politicians than of central bankers or civil servants.

Whilst looking at the parties, then, the main focus will be on European integration and the domestic economy, with some reference to sterling’s reserve currency role and the Sterling Area problem; conversely, the latter two themes will become central in the sections on Bank officials and governmental civil servants.

2. WILSON AND THE LABOUR YEARS

One may not mention the subject of monetary policy-making in relation to the British Labour Party without referring to that quintessential example of emergency measure that was the devaluation of 1967. In one single event, all the major features of the left-wing economic tenets were encompassed: the traditional bipartisan defence of the pound; the idea that Keynesian economic policies, concentrating on real rather than monetary variables, could solve any balance of payments imbalance on their own; the necessary but painful shift from the primacy of full employment to that of the balance of payments in terms of macroeconomic objectives. Some of these tenets were overthrown by devaluation itself; some others trembled; and finally some remained firm until the breakdown of Bretton Woods did not make it necessary to devalue the pound - along with all other currencies relative to the US dollar - in the Smithsonian Agreement of December 1971, thereby fulfilling the prophecy about the second coming of

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devaluation. At this stage, however, the Labour party was no longer in office, and its official and less official positions showed that the party had had the time to prepare for this event.

Why and how did the 1967 devaluation hit the party’s economic policy certainties with the destructive force of a hurricane, while the 1971 adjustment - followed by free floating and the eventually unsuccessful experience of the “monetary snake” - did not seem to have the same effect? The fact that in 1967 Harold Wilson was Prime Minister while in 1971 he and his colleagues were no more than the shadow cabinet does not explain all the story.

The real reasons for the different effect of the 1971 events on the party’s views may be found in the fact that the breakdown of Bretton Woods was taking place in a sort of step by step way which had left time for Labour politicians to understand the situation and adapt to it. It may then be argued that an ideological shift took place as a consequence of the Bretton Woods breakdown; before 15 August 1971, there had been signals that such an event was going to take place sooner rather than later, these signals had been enough to start preparing for the fall, and devise new views on different policy areas.


31 Ibid.


2.1. Labour’s way to European integration

To sum up in a brief but not oversimplified way, the Labour party had opposed European integration in the late 1950s due to the latter being seen as a fundamentally capitalist project - hence more suited to a conservative audience - but most importantly, as a federalist idea that would be, according to Tony Benn, “a loss of political self-determination”, hence depriving Britain of its sovereignty. When he formed his government in 1964, Harold Wilson initially thought it sensible to maintain a negative stance on Europe, before going through a “conversion” in 1966, from which point onwards both parties were officially pro-Europe, and the dissident groups were in minority within both parties.
by the EEC as responsible for a potential drain of funds from Britain’s “problem regions”.36

The sovereignty problem, despite its evident connection with the problem of economic policy independence,37 and despite its being rather natural in the public culture of what had formerly been an empire,38 was not however the main reason for the Labour Party to argue against accession to the community. Arguably, this was the main public reason, the one that was easiest to sell to the British electorate; and in fact, in later years, pro-Europe voices such as Harold Lever’s prevailed, arguing that the party “should beware of clinging to a nominal sovereignty - that is, control over our own destiny - at the cost of losing a real and effective control over our own destiny which we might have co-operatively if we pooled it”.39

The more subtle reasons for being suspicious of EEC entry were, indeed, to be sought in a more technical economic realm. The real questions the Wilson cabinet was debating by the mid-1960s was whether joining the EEC would lead to trade benefits40 or, on the contrary, trouble the balance of payments;41 whether it would raise or lower the national living standards;42 whether it would drive the Commonwealth into jeopardy;43 and, in the case of the left wing of the party, whether the choice was about becoming part of a capitalist trading bloc whose policy decisions the United Kingdom would not be able to influence effectively.44

All these problems were obviously just different faces of the same coin. What had not changed as the 1970s were drawing closer, however, was the division that existed within the party on this matter. Such division was dangerous and quite easily exploitable by the Conservatives for electoral purposes; as such, since Wilson’s conversion of 1966, the official line always remained strictly pro-Europe,45 provided that “essential […] interests were safeguarded”, as in the Labour manifesto of March 1966.46

International monetary views

The consequence of this strategic, and not all enthusiastic, attitude towards European integration had important implications for the development of views regarding the international monetary system. Despite not being part of the EEC, Britain was obviously well present in the minds of EEC policy-makers when, in 1969, they issued the “Hague Communiqué” in favour of economic and monetary union.47 During the first Wilson term, the Chancellors were well aware that Britain was not considered an insignificant monetary partner. On the one hand, the City of London cultivated the aspiration to become the centre of Europe’s financial markets.48 On the other hand,
sterling played a role in the monetary system, both as a second-claim reserve currency\(^{49}\) and as a guarantor of stability to the Sterling Area,\(^{50}\) and these were drivers of either enthusiasm in wanting Britain on board - thanks to its potential in fostering development\(^{51}\) - or of fears that such responsibilities would have driven the rest of Europe into the higher risks Britain itself was facing.\(^{52}\) Moreover, regardless of political beliefs, when one looked at the issue from a UK perspective - and, more specifically, dug deeper within the Labour Party - the position was not only reversed (that is, the potential for development was seen as a possible drain of resources in favour of abroad,\(^{53}\) while the idea of sharing financial risks was welcomed\(^{54}\)), but it actually proved to be quite liquid. Before the formation of the 1964 cabinet, the pro-Europe politicians could have been counted on the fingers of one hand (and, parenthetically, at the beginning they were left out of the cabinet itself\(^{55}\)), while by the end of the decade the situation, if not reversed, was at least much more pro-Europe than it had used to be.\(^{56}\) Figures such as Roy Jenkins and Harold Lever rose in importance while the Labour years went on.\(^{57}\) Clearly many factors had come into play, the most important of which had certainly been the shift in foreign trade from the Commonwealth to EEC countries: according to official statistics, the 1958 figures of 35% trade with the Commonwealth against 25% with Europe had turned, by 1968, into 24% with the Commonwealth and 35% with Europe,\(^{58}\) i.e. almost an exact reversal, which reduced the strength of the trade argument against European integration. Moreover, the international monetary situation started to show signs of crisis, which the United Kingdom could experience rather directly in the events culminated with the devaluation of 1967, a further driver towards a shift in foreign policy favourable to new arrangements that promised higher monetary stability.\(^{59}\)

However, during Labour's years in opposition, some factions of the party launched an "against the Tory terms" campaign regarding EEC entry,\(^{60}\) a controversial position on Europe that earned it the epithet of Europe's enemy as opposed to the Tories considering themselves as "the party of Europe".\(^{61}\) However, by that time this minority view only had the effect to offer the opportunity to reinforce the pro-Europe stance of prominent figures such as Jenkins, to whom "The basic issue is not Tory terms. We have one of the best balance of payments positions now, this year, in Europe; they're impressed by this and they want to see a strong Britain and that is what we've got to contribute." Harold Wilson, interviewed during BBC 1 programme Panorama, 8 May 1967. Britain and Europe since 1945, microfiche collection, Brighton: The Harvester Press, 1973, p.13.261, n.170.

51 "We have one of the best balance of payments positions now, this year, in Europe; they're impressed by this and they want to see a strong Britain and that is what we've got to contribute." Harold Wilson, interviewed during BBC 1 programme Panorama, 8 May 1967. Britain and Europe since 1945, microfiche collection, Brighton: The Harvester Press, 1973, p.13.261, n.170.

2.2. Economic decline between cycles and industrial relations

The debate on economic decline - which is well described by many writers\(^{62}\) - stemmed from the observation that there had been a slow-down in industrial productivity since the end of the war, and that as a consequence, the country's...
international role was slowly fading away. On the Labour side, such a problem came into existence during the 1960s due to the observation of two phenomena. First, there was a broad long-term shift away from the UK towards the US in terms of world leadership in most fields of international politics, the latter most notably having replaced the former in the role of world financial centre, world leader in international trade, and guarantor of international monetary stability. Secondly, a medium-term shift was observable, in which the UK suffered from a relative decline in industrial productivity, as a consequence of both a catch-up effect enjoyed by other Western countries, and a faster pace enjoyed by the same countries relative to the UK in terms of post-war reconstruction of their economies.

Departures from the “Stop and Go” approach

While at the core of the Conservative answer to this problem was a revolt against the “Stop and Go” policies, such a paradigm had been Wilson’s favourite recipe. Such convictions came to be, however, less and less popular as the economy started to find itself in trouble. Labour anti-marketeers started developing cases for free floating, as well as cases for the complete disentanglement of the country from international trade agreements. All in all, however, detachment from the “stop and go” philosophy only meant that the party became, overall, keener to accept the policy coordination that would be necessary once the country had entered the EEC. By mid-1971, just before President Nixon took the first step towards the crisis of Bretton Woods, the Labour research department was expressing views favourable to economic policy coordination, in the context of the debate on the British negotiation for entry into the Common Market.

Industrial policy and labour relations

The problem of economic decline would also become a force favourable to European integration due to Labour’s views on industrial policy and labour relations.

In terms of industrial policy, where the problem of decline was basically seen as a loss of productivity, Labour promoted the view that an EEC-wide market would foster competition and therefore reduced the productivity gap, especially in the agricultural sector.

As regards labour relations, the bone of contention had become whether trade unionist activity had created a slow-down of growth, as a consequence of the loss of working hours and artificially higher wages, and allegedly bringing about the cocktail of

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68 Some trade unionist advocates within the party, such as John Rawlings, brought forward a more extreme argument according to which the main problem was the increased power of multinational companies, which created situations “where technology and research impose scales of investment which will rule out the modestly sized companies”. John Rawlings, “Unions: The Way Ahead”, in Labour Weekly - The Newspaper of the Labour Party, no. 66, 29 December 1972, p. 8. Britain and Europe since 1945, microfiche collection, Brighton: The Harvester Press, 1973, fiche 013.263, n.384.
72 "I am frankly horrified at the prospect of moving on into the last quarter of this century, alone amongst the major industrial nations with a narrow home base of only 50-60 million.” Roy Jenkins, Europe - The Choice Before Us, text of a speech delivered at a meeting of the Labour Committee for Europe held at Blackpool on Monday 28th September 1970, Labour Committee for Europe, 1971. Britain and Europe since 1945, microfiche collection, Brighton: The Harvester Press, 1973, fiche 013.254, n.469.
75 If we are to improve our growth rate, improvement must largely come from our more technologically advanced industries [which] mostly need a large and unified market. It is precisely these industries which with very few exceptions are most enthusiastic about British entry.” Roy Jenkins, Europe - The Choice Before Us, text of a speech delivered at a meeting of the Labour Committee for Europe held at Blackpool on Monday 28th September 1970, Labour Committee for Europe, 1971. Britain and Europe since 1945, microfiche collection, Brighton: The Harvester Press, 1973, fiche 013.254, n.469.
76 This competition-driven view was especially going to emerge after 1968, when the introduction of the Common Agricultural Policy had raised a debate as to the actual benefit for the United Kingdom to join a scheme in which an activity such as agriculture, in which it was relatively weak, was so strongly subsidized at the cost of all participating countries. See section “The Common Agricultural Policy” in Dick Taverne, Monetary and Economic Union in Europe, Labour Committee for Europe, 1970. Britain and Europe since 1945, microfiche collection, Brighton: The Harvester Press, 1973, fiche 013.254, n.493.
inflation and industrial stagnation that was at the heart of the stagflation phenomenon. 76
Trade unionism being the party’s own ideological background, however, Labour typically opposed the view that trade unions might be responsible for the country’s
decline. 77 Despite this position, however, it must be recalled that in 1969 an attempt was made at introducing some sort of incomes policy, when Barbara Castle’s paper In Place of Strife was proposed 78 and, after bitter criticism from both the party and the trade union movement, 79 subsequently not implemented. This episode ended up pointing out that, perhaps, international policy coordination - avoiding the import of inflation from abroad - could have proved to be a better card to play than domestic demand management.80

2.3. Reserve currency and Sterling Area

A more technical problem related to the British monetary situation was, as mentioned, its currency’s reserve role in the Sterling Area. When in office, Wilson’s team had been very careful in pondering the consequences of this for the broader foreign policy attitudes of the country, the Sterling Area being almost coincident with the Commonwealth.81 Moreover, neither De Gaulle nor many other European politicians were favourable to the idea of letting Britain in without the latter at least substantially resizing its international monetary role.82 As a consequence, a monetary shift towards Europe was synonymous with either dismantling the Sterling Area, or reducing sterling’s reserve role.83 The former action would have obvious trade and political consequences in the foreign relations of the United Kingdom with the Commonwealth.84 The latter would have risked triggering an international monetary crisis, and this was of course becoming more and more evident as the 1960s drew to a close.85

Interestingly, what unlocked Labour politicians’ positions regarding this issue was their 1970 movement from government to opposition. A minority of them started to quote Commonwealth relations 86 as well as Britain’s international prestige 87 - often represented by the responsibility of sterling within the Bretton Woods framework 88 - among the reasons for opposing an EEC-based monetary system.89 Bretton Woods had to remain in place; Britain had to keep its responsibility in keeping it alive side by side with the United States,90 above all, there should exist no European bloc whatsoever;91 the Western world should be governed by the asymmetrical axis between United States and United Kingdom.92 For the most influential part of Labour politicians, however, the shadow cabinet experience after 1970 was the occasion to more openly unveil their own internationalist vision according to which a disentanglement from the existing monetary arrangements was healthy and desirable,93 the wide “sterling balances” held in London were effectively a risk without being a real asset, 94 and it would have been better for the

82 Letter from Thomas Balogh to Harold Wilson, TNA PREM 13/253, no. 24-25, 1 July 1965.
83 Ibid.
84 Ibid., p.7.
85 Ibid., p.7.
87 Thomas Balogh to Harold Wilson, TNA PREM 13/253, no. 24-25, 1 July 1965.
88 Roy Jenkins, Europe - The Choice Before Us, text of a speech delivered at a meeting of the Labour Committee for Europe held at Blackpool on Monday 28th September 1970, Labour Committee for
country to give up the Commonwealth preference in order to join the Common Market, which was, after all, tantamount as saying it was time to shift trade preferences towards the European continent, in line with the new historical trends of British foreign trade.95

3. TORY EUROPE

When in 1970 the government shifted from Labour to Tory, the “shift away from demand management” advocated by Edward Heath suggested that a major turn would take place. In a matter of two years, however, Keynesian policies would subtly come back through Anthony Barber’s “stimulus to demand” as announced in the 1972 budget speech quoted at the opening of this chapter, which, as has been noted, also implied some degree of international monetary disentanglement. All in all, one question stands at the core of the whole understanding of the Conservative positions, both mainstream and dissident, towards these choices: how should the main driver of Conservative ideology - allegedly, the national interest96 - be spelt out in terms of international economic policy? In other words, how could it be possible to combine a free-market ideology with the concept of creating a European common external tariff which, to any skilled observer, was quite clearly a protectionist measure?

Moreover, a corollary yet interesting exercise would be to explore how Brittan’s definition of fixed rates as “a pseudo-problem created by pretending that the pound is worth something slightly different from what it really is”97 could co-exist with the idea of the promotion of free trade, which was so obviously helped by exchange rate stability.

This brief introduction does not intend to affirm that the Tories were more contradictory than Labour at the time, as the previous section should have made clear. Even so, it is important to point out that structural change was at the basis of these

Common Market Information Service,\footnote{5} and on more than one occasion the Heath government in the early 1970s found it necessary to make sure that some dissident Labour MPs would vote with the government on issues related to the EEC, due to lack of internal coherence within the party itself.\footnote{6}

What is interesting to observe is that some of the main supporters of the social market economy, such as Enoch Powell who was certainly the most prominent figure of this group since the 1960s, and Samuel Brittan who was at the time the main Conservative commentator and therefore an important, informal spokesman of the party in the British media, were also the most fervent anti-marketeers\footnote{7} and, in the case of Brittan, also favourable to exchange rates flexibility as opposed to both Breton Woods and the EEC-based Werner Plan.\footnote{8}

As has been noted, the main areas around which the party’s positions on such issues were formed were the progress of European integration and the debate on Britain’s alleged long-term economic decline.

\subsection*{3.1. The Tories and European integration}

Since Winston Churchill’s early post-war declarations in support of integration among the countries of Europe, the overall party position on this issue had been the result of the interplay of a number of views in different policy areas. These areas were by no means restricted to international issues, and not even to economic policy. Notably, one major reason to support European integration had at some stage been that Europe was looked at as a potentially useful political bloc in order to cope with the threat represented by the possible spill-over of Communist ideology from the other side of the Iron Curtain,\footnote{9} a theme on which Douglas-Home clashed with the “social market economy” views. Moreover, the monetarist influences that characterized the Tories in the 1960s were not only confined to Britain’s reasoning on international regimes, but involved domestic considerations such as that the domestic use of the money supply might have calmed certain vested interests, namely the City.

At any rate, the economic reasons to join or not to join the EEC were at the basis of the most prominent debate going on in this field. The issues were many and complex: the problem posed by the necessity to give up part of the country’s sovereignty towards a supranational institution;\footnote{10} the cost of entry, especially due to the Common Agricultural Policy;\footnote{11} the trade pattern with abroad,\footnote{12} especially the relationship with the Commonwealth;\footnote{13} and, in this framework, the Sterling Area and how the role of sterling as a reserve currency clashed with the idea of a European project for monetary integration and stability,\footnote{14} an issue which became part of yet another debate that went beyond the one on European integration, for which reason it will be dealt with in a
separate section; and last but not least, the debate as to whether higher foreign competition would strengthen or weaken the domestic economy.  

Tory views on sovereignty

The most problematic of these issues was that by entering the EEC, the United Kingdom would have implicitly taken a commitment to give up part of its sovereignty to a supranational body which would take over some of the typical tasks of what had been the sole responsibility of government thus far. Possibly, this was just one further step in a continuum of increasing international cooperation that had already included the Bretton Woods agreements; but actually it was perceived as being something more binding than that, especially in terms of the political meaning that came to be attached to it. In terms of economic policy, the Conservative MP Geoffrey Rippon, while observing in early 1971 that “The preservation of British interests has long depended on sharing control with others, and that is already, in practical terms, an irreversible trend”, then moved on to comment that, regarding the economic and monetary union, “Our belief is that further developments in this and other fields are highly desirable. […] We should be joining the community not just as shareholding but as directors. [...] we should have far more control inside than if we remained outside.”

Rippon, of course, expressed the views of the most fervent marketeers such as Heath and Barber, whose ideas at the time determined the party’s official pro-Europe stance. At the other end of the spectrum, however, the dissidents made the sovereignty issue their strongest weapon. Not only did Enoch Powell limit himself to arguing that Britain would lose part of its sovereignty while entering the EEC, he actually made it a nationalist case, by choosing not to concentrate on easy anti-market issues such as the campaign against dearer food, and stay instead focused on “protecting the separate

116 Enoch Powell limit himself to arguing that Britain would lose part of its sovereignty while entering the EEC; he actually made it a nationalist case, by choosing not to concentrate on easy anti-market issues such as the campaign against dearer food, and stay instead focused on “protecting the separate integrity of the nation”. He made the case against giving up sovereignty for a leading role within the EEC, claiming that disillusion with the Commonwealth should create a similar disillusionment, instead of enthusiasm, for Europe; the country’s sovereignty had therefore to be defended against both internationalist temptations. His case stemmed from, or was substantiated by, economic interest. Indeed, in terms of economic and especially monetary policy, the problem of the loss of sovereignty translated into a loss of both the monetary and fiscal policy tools. At a time when the British people would soon be called to elect a new parliament, not only did he attack Wilson’s demand-side economic policy by affirming that “[...] not the least of the reasons why we are going to turn this government out is because they abused this power to finance their own soaring expenditure”. More than that, he called for a reflection on the effect of monetary integration with the EEC: “Now imagine that all this time we had had, not a currency of our own but a currency common (let us suppose) to six other countries. [...] there would have had to be a common squeeze and a common freeze, [...] a common inflation and a common policy on unemployment.” Moreover, the centre of the problem was not what policies the EEC would have pursued. Rather, it was all about why the country should have sold its own centuries-long institutional tradition so cheaply: “the Bank of England would be a local branch office of the new central bank.”

Powell’s softer supporters

In his stance, Powell was backed by a whole group in the Conservative Party. Besides the Institute for Economic Affairs, a Conservative Anti-Common Market Information Office had been started by MPs Sir Robin Turton, Sir Derek Walker-Smith, and Neil Marten. A certain sceptical attitude towards European integration could also be

118 “The idea that Europe is looking to Britain for a lead [...] is the figment of a disordered imagination. [...] [Was not Britain] already called to ‘lead’ a great multi-racial Commonwealth? There is an assortment of countries throughout the world [...] of which the sole common characteristic is that at a particular time they were all, however briefly, part of a now vanished Empire. So far as sentiment goes, one or two view Britain with indulgence, but the rest with a gradation of dislike which ranges from tolerant contempt to active hatred [...]”. The Birmingham Post, 6 January 1970, p.1.
observed within the Conservative Commonwealth and Overseas Council, especially in the figure of Sir William Gorell Barnes.

Moreover, as early as April 1968, the Conservative Research Department was already developing studies in view of a future comeback into office, and one of the policy papers on the EEC was about the possible alternatives to the EEC, a topic that was analyzed by looking at alternatives such as a Commonwealth customs union and a North Atlantic Free Trade Area in competition with the EEC, concluding that “neither by joining EEC nor by seeking to create NAFTA shall we be following the course we originally decided to set for ourselves in subscribing to the idea of an Atlantic Community.” Moreover, it was acknowledged that the UK had a somewhat peculiar role in the international community, and that as a consequence, “Whatever the course we may seek to espouse in safeguarding our economic interests, it is surely of primary importance to bear in mind that Britain is at once a European power and the heart of the English-speaking world.”

On the problem of sovereignty, this reasoning of course represented a softer view than that of Powell’s, insofar as it implied that international integration of some kind was inherently necessary for the United Kingdom. A few years later, and closer to the breakdown of Bretton Woods which would impose immediate choices, the Council would also draw closer to a pro-European stance, by specifying that its opening towards European integration depended on the fact that “By accepting an invitation to join the Community Britain will not be undertaking any obligations involving the sharing of sovereignty except to the very limited extent provided for in the Treaty of Rome.”

Moving towards a wider Europeanism

The failure of the second application, the devaluation of sterling that was necessary only a few months later, and the consequences on prices triggered by the subsequent monetary turmoil, all contributed to change the Conservative view on the Common Market. The dominant view advocating free markets began to look at the EEC as a potential step towards free trade, as opposed to a protection against the outside. And

Kingdom, whose agricultural sector was less developed than the correspondent sectors in other EEC countries. This issue was strictly connected to the widespread opinion that EEC membership would carry, at least in the short run, an increase in the general price level, and specifically an increase in food prices.

Already at the time of the second British application to the EEC, in the spring of 1967, the magazine *Three Way Contact* of the Conservative Contact Programme conceded that in the general uncertainty, EEC entry might have either positive or negative effects: “Many of the changes would present themselves in the form of opportunities - good if taken, bad if neglected.”

Although expressed in an optimistic attitude, these concerns were real: the 1968 Conservative Research Department paper on the possible alternatives to EEC membership mentioned that, possibly, Britain’s position “would have worsened from the undignified to the ridiculous if, having changed - say - our present agricultural policies to conform more closely to those of the Common Market, we were still denied entry.”

The Common Agricultural Policy

Moving into a more strictly economic territory, a second strand of problems emerged around the fact that the Common Agricultural Policy, at the time the single largest element in the EEC budget, might not have brought any advantage to the United Kingdom or other EEC countries. This issue was strictly connected to the widespread opinion that EEC membership would carry, at least in the short run, an increase in the general price level, and specifically an increase in food prices.

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even in those instances for which the EEC was clearly a protectionist scheme, the uneasy situation of the domestic economy did not allow for too much philosophy: on the EEC agricultural policy, Edward Heath in 1967 was already of the opinion that

The European Community is [...] now determined to give agriculture in its own countries a fair crack of the whip [...]. What has not been so fully appreciated is the importance for reducing the barriers to intra-European trade which have grown up between the two economic groupings of the EEC and EFTA.126

But, of course, his own electoral victory in 1970 and the subsequent governmental responsibility represented a further major change in the Conservative ranks and their position regarding the subject. At once, a mainstream pro-Europe view was established, therefore degrading anti-marketeers to the status of internal opposition. Indeed, “the Party will not distribute leaflets and information putting the case against entry”127 and the official party position that had to be portrayed was that of an enthusiastic pro-Europe stance.128 On agriculture and prices, a February 1971 publication by the Conservative Research Department reported that “Agreement was also reached on procedures for an annual review of the economic position and prospects for agriculture in the enlarged Community before price decisions are taken by the Council.”129 And on 21 January 1971, Minister of Agriculture James Prior had assured the House of Commons that on this subject “We have secured an adequate agreement with the Community in this respect and we shall ensure it is properly carried out.”130 In July 1971, completing the change, Prime Minister Heath expressed the view that “The result clearly shows that the effect on prices of British entry will be less than the last Government estimated 18 months ago.”131

If the mainstream line of the party managed to overcome its own concerns regarding prices and the effect of the Common Agricultural Policy, the Conservative anti-marketeer factions were not, obviously, of the same opinion. Powell’s views, which never changed during these years, are also useful in order to clarify why the problem of prices and the agricultural policy are central to the debate on monetary regimes:

Let me illustrate the dilemma from the monetary events of the last ten days, when the inflow of dollars into the various countries of the Community posed a problem which undeniably called for action. Immediately, the one common policy of the Community which does exist - the common agricultural policy - was called in question, because that policy would be unworkable unless there are stable accounting arrangements between one part of the Community and another, either a common currency or stable relationships between the different currencies.132

But neither Powell’s dissidents, nor the generalized floating advocated by the monetarist wings, could have an appeal on a party which had been, as most of the country’s entrepreneurship and financial establishment, more scared of the ghost of devaluation than attracted by the thrill of untested monetary experiments. Moreover, whatever the degree of internal dissent, when the time came in 1970 to file a third application to the EEC, the Conservative government led by Heath did not think twice about it, and the application process was started with a huge promotional campaign directed to both the public and the remainder of the political community, especially pushing on the economic advantages that EEC membership would have brought, as can be clearly seen from Figure 8.

130 Hansard, 21 January 1971, Col. 1324.
131 Conservative Party Archive, CCO 508/3, “The address by the Prime Minister to the Central Council of the National Union of Conservative and Unionist Associations”, Westminster, 14 July 1971.
Internal dissent and party loyalty

How about the internal dissent expressed by Powell and others? At the beginning of the decade, the danger represented by the rift between marketeers and opponents had been contained by the fact that the other party was suffering from exactly the same internal division.133 Moreover, the debate over European integration had not been used in public as an electoral weapon. It would only be during the 1970 campaign that Europe would become one of the bones of contention; but since both Labour and Tories were on the same line, in order to politicize the problem, a new light had to be cast on it. Hence, the Tories started to develop a critique of Harold Wilson’s attitude towards Europe.134 The quintessential examples of this is the collection of his quotations contained in the 1971 collection “Europe: Words to Remember”, published by the Conservative Research Department, whose text came from parliamentary debates on various European issues.135

Along the same lines, after defending their own views on Europe during the campaign, upon defeat the Labour Party started to campaign “against the Tory terms”. Many Labour MPs would have endorsed these views as expressed by their own anti­marketeer Ron Leighton in a 1971 pamphlet: “Rippon’s Surrender Terms. Due to prior concessions on all matters of substance, the Brussels ‘negotiations’ were largely a farce dealing with a limited number of marginal issues.”136

But this competition between the two parties did not undermine Tory ideology regarding Europe. By this time, some international events had changed the situation in a way that, it may be argued, strengthened the unity of the Conservative position around a positive, all-round view of European integration.137 First of all, French President De Gaulle’s retirement came as the long-awaited signal that the tide might change: as early as February 1970, the Conservative Commonwealth & Overseas Council observed that “[As regards monetary and fiscal policies] in the new spirit which has begun to develop since the resignation of General De Gaulle, there are indications of a greater willingness by member countries to seek means of securing a great degree of integration in these fields.”138

Moreover, the monetary troubles offered a possible case to support the type of monetary integration that had been approved at the Hague in 1969 with the adoption of the Barre Plan. In 1969, the future Prime Minister Heath observed that

“a wider uncertainty persists in monetary matters as a result of the increase in Britain’s indebtedness, the continued deficit of the United States, the devaluation of the franc, and

the tendency of Germany to run a trading surplus. [...] These pressures in favour of new action in bringing together policies of European countries were clear when the change of President in France took place. 139

Finally, a slow but tidal shift in trade patterns was making Commonwealth preference less and less advantageous to the United Kingdom. 140 Each of these processes, while reinforcing the mainstream views, contributed to weaken those of the dissidents.

3.2. Tory views on Britain's economic decline

The Tory party experienced a debate on economic decline stemming from the same premises that have been sketched out in the correspondent section on Labour. In this light it is worth noting that such debate was going to last for a long time: notably, the idea that Britain required a policy overthrow in order to regain what it had lost was still Margaret Thatcher's main assumption. 141

The Conservative views on the causes of decline were, of course, various. It is possible to isolate four areas that became the bone of contention on economic policy, and that were used by Conservatives of both traditional and "social market economy" as scapegoats for the problem of relative decline.

First came the Keynesian interventionist views on the role of real economic variables, which most Tories criticized, 142 even if their slightly different viewpoints led them to diverging conclusions on the desirability of European integration, the general assumption was that Keynesianism had been responsible for the United Kingdom's alleged poor economic performance in the post-war decades. 143 Secondly, taxation and public expenditure played a role in dividing the Conservative camp: while the traditional Tory would not necessarily object to the use of the fiscal lever as a matter of principle, supporters of the social market economy saw public sector expansion as an abuse against the free market mechanism and therefore a cause of inefficiency. 144 Third came industrial policies, a debate spinning around the problem of how to improve productivity and how to foster industrial growth, 145 and a debate in which the existence of the City of London played a paramount role in defining certain vested interests regarding, for example, the international opening of markets for both commodities and capital. 146 The fourth and final scapegoat, perhaps the most popular in the late 1960s, were the trade unions: correlations such as the one between artificial wage rises and inflation, as well as the one between hours lost for strikes and increases in production costs, or a combination of the two, were typically taken into account when it came to make a case for the country's relative economic decline. 147

While all of these four policy issues were constantly used by Conservatives in order to blame the policies implemented by the other party, two of them in particular had a special effect on the views on international monetary choices that the country would face in the early 1970s: the views on Keynesianism, and the claims regarding industrial policy.

Keynesianism, monetarism, and exchange rate flexibility

In terms of views on Keynesianism, traditional Tories claimed the need for as little state intervention as possible, and promoted a view according to which principles and theories of any kind should not have been used as tenets of policy, as the latter should have been carried out by short-term accommodation of the different political forces by

means of common sense.\textsuperscript{148} Obviously, such a view could have never come to terms with Keynesianism, the latter calling for a high degree of public intervention in the economic life of society, in order to foster and redistribute wealth. On the other hand, theorists of a social market economy were in a way aligned to the traditional view insofar as they too pushed for a less interventionist government. Both views would therefore sympathise with Friedman's monetarism as soon as it came to the fore of the debate in the early 1970s.

In this light, it becomes easier to understand why from 1970 onwards Conservative thinkers on both sides - for instance Neil Marten for the traditionalists\textsuperscript{149} and Brittan for the social market view\textsuperscript{150} - started to explore the exchange rate flexibility issue with renewed interest. As to the conclusions that were reached, however, two different outcomes may be outlined. The former, mainly supported by Brittan's work, was that exchange rate flexibility was to be looked at as an absolute - to a certain extent it was like treating the money market in the same way as other free markets - and therefore an unregulated situation of totally floating exchange rates would have been the one from which the world economy, and the United Kingdom in particular as a developed player in such economy, would have benefited the most.\textsuperscript{151} The latter view instead, promoted by strong Europeanists like Chancellor of the Exchequer Anthony Barber, was that exchange rate flexibility, despite being an important part of the general call for market freedom of which the Conservative ideology was the strongest supporter, should however be limited to flexibility among "optimal currency areas."\textsuperscript{152}

The general outcome of the debate was that Brittan's ideas contributed to the growth of discontent towards Bretonn Woods, even if in the short run they did not prevent the


\textsuperscript{151} Ibid.


Conservative government from developing more and more sympathy towards the European fixed exchange rates system which was started by the Werner Plan: in November 1970, the governmental position expressed by Geoffrey Rippon was that "When we have got the enlarged Community and you have, after some transitional period, (free) capital movements within the Community, well then you begin to form the base of a European reserve currency rather than one of Sterling. So Sterling is an asset which we would bring into the Community."\textsuperscript{153} Within the party, once the bitter critique of Bretonn Woods became widespread even outside the promoters of the social market economy, the Europeanist views prevailed.

\textit{Industrial policy}

On top of this argument was the debate about industrial policy, focussed on the problem of productivity. The international side of this issue was whether free trade would have strengthened or weakened British industry as a whole. Moreover, monetary stability was seen as a necessary prerequisite for the functioning of London as an international financial centre. The strong connection of the City with the Conservative party therefore ended up determining a certain degree of support granted by the Conservatives to the issues of free trade and exchange rates stability, in any form the latter might have been achieved. As early as 1968, the Conservative Commonwealth & Overseas Council's analysts expressed the view that capital liberalization in the EEC context was a risk worth taking in order to reaffirm the City of London's supremacy as a European financial hub:

The commitment to liberalise somewhat movements of capital within the EEC might be a little alarming to the Treasury particularly if no means could be found of ensuring that Europe was not used as a channel for moving capital to North America. We feel, however, that provided our developing current balance of payments surplus is not allowed to disappear, this should not constitute a serious danger; and that, in any case, the risk such as

it is worth running for the sake of securing the advantages of establishing London as the financial centre of Europe as soon as possible.\textsuperscript{154}

This side of the debate on economic decline, therefore, moved back to being aligned with the previously described rift between segments of the Conservative Party which, once it became clear that Bretton Woods was no longer going to be a long-term option, thought it necessary for the country to switch to another fixed exchange rates system, namely the “monetary snake” proposed by the Werner Plan,\textsuperscript{155} and that minority of the party which, either being anti-market for ideological or economic reasons, claimed a disentanglement from Europe too, and even possibly the free floating of currencies in the world money markets.\textsuperscript{156}

3.3. Minor issues: the reserve currency role and the Sterling Area

The strong connection between both the reserve currency and Sterling Area issues and European integration should already have provided a good hint as to what the official Conservative position would be on these issues. The Conservative establishment’s early decision that the United Kingdom ought to enter the EEC, dating back to the Macmillan government,\textsuperscript{157} determined that the leading Tories had since that time accepted the view that a reduction in sterling’s reserve currency role was necessary.\textsuperscript{158} In his early 1960s role as the government’s “man of Europe”, Edward Heath described the role of sterling within Breton Woods as a reminiscence of a past role which was no longer motivated by the international situation of the time.\textsuperscript{159} A real problem with the Sterling Area would not emerge until the early 1970s, but when it did, Heath’s view was in line with the former position on sterling\textsuperscript{160}; and this was all the more straightforward given the trade figures that showed the import-export activity with EEC countries to have overtaken that with Commonwealth countries.\textsuperscript{161}

\textbf{Dissidents and vested interests}

Even so, some people within the party had different views. One group had interests related to the Commonwealth and would not accept a phasing out of the Sterling Area as easily as Heath suggested. In particular, there were Tory MPs - John Biffen, Richard Body and Arthur Bryant among the most prominent - whose views were close to industries whose international business extended to the Commonwealth and to whom not only was the phasing out of the Sterling Area an unwanted circumstance;\textsuperscript{162} these people also held Europe to be a danger to their own business interests, for roughly the same competition reasons that pushed other business people to welcome the idea.

The second group of dissident views was, as usual, that of the traditionalists consisting of Enoch Powell, Robin Turton, Derek Walker-Smith and Neil Marten, to whom a fundamental change in the country’s pattern of trade was not desirable for a host of reasons ranging from the defence of the idea of the United Kingdom’s international responsibility to more economic cost-benefit analyses on the costs of entering an EEC-centred framework compared with the loss of the trade benefits generated by the existence of preferential agreements with the Commonwealth, of which the Sterling Area was the monetary parallel.

As this debate developed during the first year of the Heath cabinet, it emerged quite clearly that the internal opposition to what were seen - at least before De Gaulle’s retirement - as necessary steps towards Europe, was not to be undervalued. In particular, Powell’s group was a potential source of instability to the government itself, in the light of the double decision that had to be taken after the summer of 1971, when Parliament

\textsuperscript{158} Stephen George, Britain and European Integration since 1945, Oxford: Blackwell, 1991, p. 46. Moreover, Macmillan believed that “far from straining Anglo-American relations, Britain’s joining the Community might well lead to much closer and more far-reaching transatlantic links than the British could hope to achieve in other ways”. Miriam坎普斯, Britain and the European Community 1955-65, London: Oxford University Press, 1964, p. 336.
\textsuperscript{160} Ibid.
\textsuperscript{161} His Majesty’s Stationery Office, Britain and the European Communities: An Economic Assessment, London, 1970.
\textsuperscript{162} See in particular the publication Britain Overseas, official magazine of the Commonwealth Industries Association, vol.1, no.3, May/June 1971.
would have to vote on EEC entry as well as on the renewal of the Sterling Area agreements. The uncertainty over the outcome of this double step was one of the leading reasons that made the Prime Minister decide to renew the Sterling Area agreements, hence not challenging the Parliamentary majority to take a courageous step in this sense. EEC entry would have been more acceptable if not seen as the choice that killed the Sterling Area and therefore sterling’s special role in the international monetary picture.

However, as will be pointed out later, the process was not altogether easy: on what was described as the country’s most important foreign policy decision of the post-war period, Powell remained firmly opposed, which determined that the actual outcome of the parliamentary debate, due in the autumn of 1971, remained very uncertain. Even within the Conservative party, then, the position on the monetary regime stemmed from a diverse range of views on a number of other issues, forming a patchwork whose outcome, as late as of the summer of 1971, would still have been difficult to predict.

4. THE BANK OF ENGLAND UNDER LESLIE O’BRIEN

Many assessments have been made as to what extent the nationalization of the Bank of England in 1946 brought about a higher degree of governmental control over what had been one of the oldest and most influential institutions of the United Kingdom for more than three centuries. Within the framework of post-war economic policy, and its four objectives suggested in the mainstream schematization offered by Jim Tomlinson, the Bank certainly retained a high degree of influence over the making of policy. Such influence created a number of misunderstandings between central bankers and government, as can be observed at several different points during post-war British history.

The peculiar position of the Bank also opens up to an observation that is central to this research: if it is true that the 1960s and early 1970s witnessed a shift in the main goal of economic policy from full employment to balance of payments targeting, then it is also necessary to consider how such a shift led to a potentially more influential role of the Bank during these years. Indeed, while the full employment goal was pursued mainly through fiscal policy, the balance of payments was generally addressed in monetary policy terms. While the Bank could not have a direct say on the government’s fiscal policy, it arguably had much more leverage as regards monetary issues, and therefore it gained a larger and larger importance while policy-making started to concentrate on the latter at the expense of the former.

As has been said, of the four main issues involved in the shift from Bretton Woods to European monetary integration, central bankers were particularly keen on developing views on the two most technical issues, while keeping a less clear profile in terms of the more easily politicized themes of European integration and the domestic economic performance; that is, exactly the opposite stance from that of the politicians described in the previous sections. The following sections, then, will adopt the same framework, but with opposite sign: the two technical problems will be dealt with first, while the more politicized will be mentioned subsequently.

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167 This “division of labour” between monetary and fiscal policy reflects the Mundell-Fleming approach, which is basically Keynesian. Full employment, the “internal balance” needs to be controlled through fiscal policy, while monetary policy is reserved to the control of the current account of the balance of payments, the “external balance”. Robert Mundell, International Macroeconomics, 1968.
168 An alternative view was offered by the New Cambridge School, which advocated an exactly opposite policy mix: fiscal policy in order to shift the consumption and investment levels and consequently keep the current account around a certain target; and the money supply in order to contain inflation, so as to impact on the employment level. John McCallum and David Vines, “Cambridge and Chicago on the Balance of Payments”, Economic Journal, vol. 91, 1981, pp. 439-453. F. Marzano, “Il Cambridge debate e l'assegurazione di strumenti ad obiettivi nella politica economica”, Ricerche economiche, vol. 29, 1975, pp. 3-41.
disease. This cleavage in economic policy views regarding the domestic economy might have been solved in the context of the dialogue between Bank and government, had the entire issue remained confined to domestic dynamics.

Internationally driven problems

From outside the domestic economy, however, problems had started to arise while the 1960s drew to a close. The risk of a run on the pound as well as Britain’s current account deficits forced the government to devalue the currency in 1967, while the United States’ balance of payments deficits made it necessary, in 1968, to introduce measures such as the SDR scheme and the gold pool in order to try to limit the risk that speculative attacks might disrupt the fixed exchange rates system. Moreover, De Gaulle argued that the presence of the City of London and the existence of large “sterling balances” in the form of claims on sterling held abroad - which by the late 1960s exceeded the Bank of England’s actual reserves - would be a risk that the United Kingdom should by no means be allowed to share with the rest of the EEC.

The Bank’s attitude towards these observations was not only influenced by the French veto on British entry, but was more generally a projection of the government’s views in terms of economic theory. Indeed, O’Brien did not believe in Keynesianism; to him, the correct remedy for an over-inflated economy was a more flexible monetary policy. While being a fair player and always endorsing the government’s choices once they had been made, his advice would always run along the lines of a sort of proto-monetarism, as emerged clearly in the introduction of “Competition and Credit Control”

4.1. Sterling as a reserve currency and the potential threat to the EEC

Not surprisingly, the supporters of sterling’s reserve currency role tended to be central bankers and civil servants, sometimes even more strongly than the most nationalist politicians. It is in this picture that the Bank of England’s government by Leslie O’Brien, whose mandate began in 1966, initially seemed to continue the long-established tradition that saw the fixity of the exchange rate as the flagship of Britain’s international prestige.

O’Brien had been chosen by Harold Wilson in an attempt to appoint someone whom he thought he could easily control and at the same time, ostensibly, make a show of meritocracy. The choice did not create an easily controllable Bank, however, as Wilson had forgotten to consider to what extent a man’s convictions in terms of economic policy might get in the way. Although it is true that O’Brien always showed loyalty to the government’s choices and to the latter’s indications as to what the national interest would be, the governor’s proto-monetarist economic views made the Bank a difficult actor to deal with, especially considering the unemployment problem which started to haunt the British economy since the mid-1960s. In this picture, O’Brien believed the whole issue to be a consequence of the government’s Keynesian response to rising unemployment, in line with what had been Lord Cromer’s view thus far - that is, its decisions towards high public expenditure - and, much like his predecessor, advocated a stronger use of monetary rather than fiscal policy in order to cure the

171 “HMT comments on HMT paper on OSA diversification”, TNA T312/1701, 1 March 1967.
174 After the 1967 devaluation, during 1968 and 1969 the Bank of England Quarterly Bulletin was, indeed, dominated by claims about the need for a more active use of the monetary lever in order to manage the domestic economy.
175 “Note of a meeting at No. 10 Downing Street at 3 p.m. on Wednesday, December 23, 1964”, between Prime Minister Wilson, Governor Cromer, et al., TNA PREM 13/237, n. 5-10, 24 December 1964.
177 “Some real and specific reduction of expenditure in the Public Sector would have far the greatest beneficial effect on confidence. If an early announcement of this is not possible, then one is thrown back on further restraint on consumer demand. In this field it is my belief that some measure in the Hire Purchase field would achieve the best effect as indicative of our intention to live within our means.” Letter from Governor Cromer to Prime Minister Wilson, TNA PREM 13/237, no. 11-14, 24 December 1964, p.4.

(CCC)\textsuperscript{183} - a package of measures introduced in 1971 and aimed at reducing credit controls - as well as in the negotiation of the Basle Agreement in 1968.\textsuperscript{184} As the United Kingdom’s economic performance always remained his own major concern - and as he was especially sensible to the modernization debate - the Governor started not only to accept that integration in the EEC context could be a solution to the industrial slump, but also to contemplate the possibility of monetary integration as a sort of monetarist way out of the unemployement problems that had troubled the country since the mid-1960s.\textsuperscript{185}

In order to be brought about effectively, this possibility had to be combined with the dismantling of certain traditional tenets of British economic policy. The international role of sterling as a reserve currency was the foremost of these: if phased out, it would help calm the continental worries about the risk that was inherent in the fact that the “sterling balances” exceeded the country’s official reserves. Even though the Bank still disliked Operation Brutas, which is to say, the Treasury’s prospective solution to this problem - as is witnessed by Oliver and Hamilton’s interviews with Bank officials\textsuperscript{186} - yet at some stage it became necessary to recognize that some action had to be taken in that direction. In Robert Pringle’s words, “It is not clear when the Bank became reconciled to the end of sterling’s role, but the sterling devaluation of 1967 persuaded many Sterling Area countries of the need to diversify their reserves, and several wanted to hold the bulk of their reserves in dollars.”\textsuperscript{187}

Such views, endorsed by O’Brien, on the phasing out of sterling’s reserve currency role, as well as on the inclusion of the United Kingdom in the framework of the recently reaffirmed idea of European monetary integration, may lead some to think that during those years the Bank may also have been relaxing its own views regarding the loyalty to the existing Bretton Woods fixed exchange rates: after all, exchange rate flexibility was another idea brought forward by Milton Friedman’s monetarism.\textsuperscript{188} It is important to take into account this changing attitude when considering how and why the Bank ended up switching from the strenuous defence of Bretton Woods to a more or less open support of the Treasury projects of contingency planning - Heeboa, Priam, Palinusus and Baytown - which will be presented in the next sections.\textsuperscript{189}

\textbf{Other voices arguing for a change}

At the same time, and despite the fact that O’Brien’s long-established career within the institution made him a powerful governor, his was not the only voice in Threadneedle Street arguing for a change. In previous years, advocates of floating had not really flourished in the Bank due to Lord Cromer’s firm support for fixed rates.\textsuperscript{190} After the 1967 devaluation, it started to become progressively clearer that Bretton Woods was suffering from an incurable disease: be it brought about by the lack of coordination among monetary policies on both sides of the Atlantic;\textsuperscript{191} be it due to the “benign neglect” inaugurated by the Nixon presidency;\textsuperscript{192} or be it consequential on the higher degree of capital movement freedom.\textsuperscript{193} The fact of the matter was that the Bretton Woods parties came to be continuously under the risk of speculative attacks, which several times during the decade had already led key currencies to either devalue or revalue the parity outside the 1% allowance.\textsuperscript{194} These elements favoured the erosion of the traditional loyalty the Bank had maintained towards the Bretton Woods system.\textsuperscript{195}

While keeping a straight face in public, the Bank’s officials started to consider alternatives to Bretton Woods, especially in the form of a “European bloc” that would provide international monetary stability in spite of the “one world” solution provided by Bretton Woods.  

A European solution to the crisis would have probably meant a reduction, if not a complete phasing out, of sterling’s reserve currency role. De Gaulle’s concerns about the sterling balances were also shared by many other European policy-makers, and although the British entry negotiations had resumed and reached an advanced stage by the beginning of the 1970s, the sterling balances problem continued to prove a major problem, as witnessed by the British negotiators themselves, as well as Pierre Werner’s own stance against British entry, because of an alleged incompatibility of the British pound with the would-be European monetary union whose path had been agreed since the summit of the Hague in 1968. The Bank’s chief negotiator ensured strong support to the governmental position when defending the idea that monetary issues were a matter of discussion but not of negotiation, however vague such distinction might have been. 

Coming back to the broader international monetary system, and as a consequence of the atmosphere created by this reasoning, the only way the Bank could accept Britain stepping out of Bretton Woods was that the latter should have been wrecked by someone else. Until that point, O’Brien and his staff would have fairly and fiercely defended the fixed exchange rate, claiming that “more radical changes” would be “unnecessary”. After that, however, they would probably have become keener on looking at European integration as the best option.

**4.3. The more political sides: European integration and the domestic economy**

The previous two technical points could not avoid touching on the more politicized issues of EEC integration and its consequences for the performance of the domestic economy. The problem for the Bank of England in this context was whether the Sterling Area still made sense, or whether on the contrary its benefits would have been outweighed by those which EEC monetary integration could imply.

A second issue, very directly connected with the phasing out of sterling’s reserve currency role, was the possibility of dismantling the Sterling Area: this was indeed the monetary side of the previously introduced trade issue regarding the problems represented by Commonwealth preferential tariffs. While the preferential tariff debate was shaped by the United Kingdom’s having to give up the economic advantage coming from free trade with an area that was wider than the borders of EEC’s common external tariff, hence raising a question over asymmetry, the problem with the Sterling Area was that the Bank of England could have continued to play the role of international central banker towards those countries that held official reserves in British pounds, exposing the country to potential risks. If the EEC had to evolve into a monetary union as had been stated in the Hague in early 1968, a potential run on the British currency would have translated into a potential crisis extended automatically to the whole EEC through the fixed exchange rates mechanism.

4.2. Dismantle the Sterling Area?

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198 Ibid.


200 “The idea of widening margins to 2%, however, which the U.K. has advocated, has received little support and may yet be dropped. [...] Our line is to favour a report, however small, and to make sure that it covers the whole ground and sets out as convincingly as possible the reasons why more radical changes have been found unnecessary.” “Exchange Rate Flexibility”, Bank of England Archive, OV38/96, 20 April 1970.


204 In a fractional banking environment, a country default leading to a claim on sterling balances might have triggered a run on the pound, the hedging of this being clearly a cost.


206 The Sterling Area guaranteed Britain a stable monetary area roughly coinciding with the extent of the Commonwealth, ensuring stable trade and capital movements among its member countries.
economy. Indeed, both of them listed European integration among the causes. Moreover, at least the sterling balances problem could be related to the debate over the management of the domestic economy in the way that has been described: that is, the role of sterling as a reserve currency would probably not have become such a problem without the unfortunate combination of domestic socio-economic troubles and the international monetary turmoil of the late 1960s. Although it was correct to present the technical issues first - as they were the main focuses of the Bank’s debate and competence - it is now time to explore the Bank’s views on these broader themes.

In 1966, the same year O’Brien was appointed governor, the official policy of Harold Wilson’s government turned to look positively on a potential British accession to the EEC. By that time, as opposed to the previous period of European enthusiasm of the earlier Conservative governments, the issue of monetary integration had also been put on the table. Hence, the Bank was also responsible of guaranteeing that the government’s policy choices would be viable, and looked at as viable. As a consequence, the Bank’s response to the French concerns was the development of a cost-benefit analysis in order to assess whether it would have been feasible to move towards a reduction of sterling’s reserve currency role and therefore of the “sterling balances” that, allegedly, made Britain’s entry into the EEC risky for the monetary stability of the entire organization. Such an attitude, oriented towards the promotion of the possibility of integrating the United Kingdom within the European economic and monetary framework, was possible mainly thanks to O’Brien’s mentioned views towards the EEC as a solution to the impasse of a domestic industry which badly needed modernization in order to become more competitive on the international stage.

Such a view would change over the years, in order to accommodate the governor’s views with the governmental definition of national interest. Most interestingly, it must be noted that the most problematic element in this relationship was not the Conservative victory of 1970 - which translated into Heath replacing Wilson at No. 10, and Macleod replacing Jenkins at No. 11. Indeed, the new government had not had the time to prepare for victory, and its initial measures were rather a continuation of the previous one, at least speaking in terms of economic policy. More specifically, at the Treasury, both Jenkins and Macleod were convinced Europeans, as well as oriented to keeping a certain monetary discipline despite the Keynesian (explicit or implicit) policies implemented by both. The real shift came when in 1971 Macleod’s sudden death made Anthony Barber rise to the rank of Chancellor of the Exchequer. From that point onwards, the Bank had to deal with a Treasury leader who was ready to make use of every policy except those that would have increased trade unionist pressure - monetary contraction aimed at containing inflation being one of these - and finally was ready to use the Keynesian lever much more freely than his predecessors.

While the favourable stance towards European integration continued to be easy to hold in the face of the broad governmental support it retained, the debate over the correct response to the domestic economic situation started to become more and more focused along the lines of a Bank advocating interest rate management against a government which, afraid of the monetary lever, preferred to push policies towards public sector expansion and, failing that, even towards exchange rate flexibility.

5. BANK AND GOVERNMENT IN ECONOMIC POLICY-MAKING

The British government can be looked at from two different but complementary viewpoints: on the one hand, on the Downing Street side, politicians held the power of saying the last word on all lines of policy; on the other hand, at Whitehall, civil servants had the expertise and were free from the uncertainty connected to the need for political

214 See Governor O’Brien’s biography at http://www.oxforddbs.com/view/article/60373/docPos=22
support. Such a structure reflected the ties the government as a whole maintained with the other actors directly involved in economic policy-making and described in the previous sections: the Cabinet members came from the political arena and, as such, maintained close contacts with the parties; the civil servants within the administration, especially Neale and Rawlinson at the Treasury, worked in close connection with the Bank of England’s officials. When it came to economic policy-making, the departments involved were the Department of Economic Affairs, the Board of Trade and the Treasury itself, as the latter was clearly the centre of decision for monetary policy, that department is where the present research is concentrated.

When describing the Treasury’s positions on economic policy-making, one should not forget this institution’s double-headed nature. During the years from Harold Wilson’s first arrival at No. 10 Downing Street in 1964 until his comeback in 1974, a time framework that also roughly coincided with Leslie O’Brien’s governorship, two very different prime ministers - Wilson himself and Edward Heath - were in charge of the government, while No. 11 Downing Street had four different inhabitants: Callaghan and Jenkins on the Labour side, Macleod and Barber for the Tories. Hence, against the proto-monetarist balance of payments targeting implemented by O’Brien - which became the Bank’s main official guideline for that period - two party platforms and four different individuals brought forward the government’s economic policy views. Jenkins replaced Callaghan immediately after the sterling devaluation of November 1967; however, the largest change during this period took place in 1966, when the National Plan was introduced after Labour’s re-election, replacing the “Stop-Go” management that had characterized economic policy-making thus far. Such a return to planning was also, according to some, a prologue to the 1967 devaluation, after which the pressure on the government to defend the parity was somewhat released. Despite not bringing about major changes in the Keynesian orthodoxy promoted thus far, Macleod represented a short parenthesis “away from demand management towards less interventionist supply-side policies that, it was hoped, would stimulate growth and lead to an abatement of inflationary pressures”. His premature death, however, possibly prevented the Heath government from becoming - in Roger Middleton’s words - “a precursor of the Thatcherite project”. Indeed, a short while after Barber entered into office, an inflation-boosting policy was implemented, in a way that continued the pre-Macleod policy lines, and then took them much further, by keeping demand at unsustainably high levels in order to keep unemployment down at the expense of the current account. All in all, within ten years the Treasury had experienced an almost complete spectrum of the policy views existing at the time.

As to the Whitehall side, the administration was much more inclined to look at the Bank’s positions than at those brought forward by politicians. Indeed, Treasury civil servants held closer ties with Bank officials than with their own political superiors. This was mainly due to the fact that most of these choices dealt with daily business; however, in the end it also had an impact on the management of medium and long-term strategy. Apart from giving the general direction, both the Prime Minister and the Chancellor of the Exchequer do not appear as often in the archival material regarding the technical discussions over the monetary crisis of 1971. The main role of the Cabinet was to run the economic policies of the country; in the British tradition of autonomy of the Bank, and in the equally British tradition of institutional bipartisanship, as has already been noted, most of the time governments were seen as the managers of fiscal policies and other contingency planning, whereas the other agencies - in this case Bank and Treasury’s administrative staff - were seen as the custodians of traditions and rules, and even as those who made sure that the harmful choices of the different Cabinets would not endanger the long term position of the country. In fact, the main people involved in the confidential exchanges of memoranda and letters with the Bank in May to August 1971 were Treasury administrative officials; the final results of these discussions were brought up to the Chancellor or to the Prime Minister for approval, and to receive further indications as to how the executive wished policies to be shaped.

The government and Bank, therefore, despite trying to act in a cooperative way, came to be at odds by the end of the decade: no government would easily consent to sacrifice fiscal policy in order to either use monetary policy or defend the exchange rate. This was due to elements mainly independent of political colour, and which had both a domestic and an international component.

The domestic economy and the 1971 budget

On the domestic side, the figures of the British economy by the end of 1970 saw a steep rise in both prices and earnings, accompanied by a growth of about 5.5% in real incomes due to the differential between the two growth figures leading to a growth of 3.5% in personal consumption. The rise in prices, however, made industrial costs too high relative to the small increase in output, making British policy-makers face the much feared "stagflation".

When writing the Budget to be discussed in the first months of 1971, the Heath government concentrated on the industrial costs issue as a cause of inflation, the basic idea being to increase output and encourage investment as a remedy against "stagflation". In order to do so, the policy that was implemented was one of tax reduction (a cut of 2.5% to the standard rate of income tax) and increase in public expenditure. Such an operation was financed by running a central government deficit, and trying to back it by a roughly equal amount of official sales of gilt-edged stocks in the fourth quarter of the 1970/71 financial year. This was a Keynesian policy reversed: instead of financing public expenditure with higher tax revenues, the government tried to finance it with a rise in the domestic borrowing requirement resulting in a deficit. The move was clearly conceived in order not to inhibit disposable income, the latter being an important stimulus to investment. However, this implied a neglect of the Bank's claims regarding the balance of payments position, which would have called for a tighter domestic management on the fiscal side in order to keep the current account surplus at an acceptable level.

The downward trend of foreign interest rates

Meanwhile, on the international side, the monetary picture had become much more unstable. Several realignments of major currencies had already been necessary - one of which had been the sterling devaluation of 1967 - and they showed a realignment was possible because of a provision in the IMF rules. The idea that the United States was leading many other countries to inflation in order to finance its own growth was widespread, and it found confirmation in the downward trend of interest rates in which many countries found themselves towards the end of 1970, as a consequence of the monetary policy adopted by the Federal Reserve, in turn a consequence of the subordination to both international political objectives and the re-election worries of the Nixon administration, rather than to a more long-term and internationally responsible behaviour.

From November 1970 to February 1971, the Federal Reserve moved the discount rate down five times by 0.25%, thus resulting in a total adjustment of 1.25%, from 6% to 4.75%, leading all major industrial countries to adjust accordingly - as shown in Figure 9 - in order to avoid large money inflows which would have threatened the ability of these countries to maintain the Bretton Woods par value for their exchange rate.


21 As was pointed out in Chapter 2, a realignment of more than 1% was possible in special circumstances of "fundamental disequilibrium", but the Articles of Agreement failed to specify what these circumstances were and, most importantly, who was in charge of deciding when a disequilibrium was "fundamental". Articles of Agreement of the International Monetary Fund, Schedule C, Article 6, http://www.imf.org/external/pubs/fuita/index.htm. Adopted at the United Nations Monetary and Financial Conference, Bretton Woods, New Hampshire, July 22, 1944. Entered into force December 27, 1945.
monetary policies. Moreover, the “Competition and Credit Control” package introduced at the beginning of the 1970s, although certainly useful in achieving other results or dampening other problems, emphasized the different views of central bankers, civil servants and politicians. With the acceleration of inflation at the end of the 1960s, the Bank became aware of the fact that the ceilings imposed on banks over their possibility to give credit were distorting the market and therefore dampening the economy. The assumption here was that they were not efficient instruments of demand management. Without them, the demand curve in the money market would have been able to shift according to market pressures, as in Figure 10.a., and this would have fostered growth without worsening inflation. Unfortunately, something went in a different way. As described by Roberts and Kynaston, and shown in Figure 10.b., instead of stimulating growth as the main consequence, the effects of the looser credit policy passed through interest rates, making them rise but not having an impact on inflation.

As a result of these attempts at addressing both domestic and international dynamics, by the end of 1970 the British rates were slightly higher than those of the other industrial countries, leading to massive inflows of foreign exchange into the United Kingdom. The downward adjustment of Bank rates started only on 1 April 1971, from 7% to 6%, when the Bank tried to lower the growth of inflation with a move which would be repeated several other times before the end of the year.

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The effect of CCC and the “rules of the game”

Before the two devaluations of the pound in 1949 and 1967, the Bank’s officials view of politicians pushing for devaluation was that they were as usual seeking “an easy way out” from the more pressing problems of excessive public expenditure and lax
The current account of the British balance of payments was experiencing a large surplus, which was even enlarged during the first months of 1971, when the Deutschmark and the Dutch guilder were allowed to float freely for a temporary (but not specified) period of time, while the Swiss franc and the Austrian schilling were revalued against the dollar. As explained in Figure 11, this made sterling even cheaper for as long as it would play according to the "rules of the game".

An inflated sterling opened a number of questions, which can be summarized along the lines of the structure adapted for the previous sections: did sterling as a reserve currency represent a threat to the EEC? Should Britain dismantle the Sterling Area? And then the more political questions: how about European integration at large, and the country's perceived economic decline?

5.1. Sterling as a reserve currency and the potential threat to the EEC

In a recent paper, Richard Roberts suggested that the two devaluations of sterling, in November 1967 and June 1972, represented the watershed of the United Kingdom's approach to the role of sterling. 227 To reinforce such position, one may add that the two devaluations were indeed carried out by two Cabinets of different colour, which to a certain extent proves the super partes nature of the issue. In a decade of huge international changes, it is likely that Whitehall's views may have shifted from a proud defence of the pound towards a more humble reconsideration of its role sometime

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between the first and the second devaluation, along the same lines as the Bank’s development described previously.

Roberts himself opens a window towards this possibility by dealing with Nixon’s decisions of 15 August 1971 as one of the main external events influencing British policy-makers.228 Some preliminary evidence for such a thesis may be found in the Treasury’s description of the role of the sterling balances within the framework of the EEC negotiations: while not accepting to consider them as a matter of negotiation, and therefore creating the somewhat artificial distinction between negotiation and discussion, British negotiators implicitly took the view that the reserve role of sterling had to be somewhat defended while the country moved towards European integration,229 even in the light of the monetary union which, since the 1968 summit at the Hague, and still as late as early 1971, was seen as a goal to be reached by 1980. The tone of the negotiation, however, was progressively smoothened while it started to become clear that soon there might no longer be a Breton Woods system to link sterling to,230 and without a “one world” system, the reserve currency role of the British pound would remain a cost without yielding monetary stability, which represented the payoff in order to ensure which the entire post-war monetary system had been designed.231

Moreover, common sense also suggests that if there are two watersheds, a valley must exist in between. That is to say, if the 1967 devaluation is read as a turning point in British policy-making, then why was the defence of the pound resumed as a policy after 1967,232 so that it had to be abandoned again in 1972? It is easier to list the reasons that surely did not act as drivers. Among these, one is the defence of sterling’s international role, as has been pointed out.233 Another one is certainly the pursuit of a balance of payments target, since the balance of payments was already in surplus234 and the equilibrium between current and financial accounts was satisfactorily guaranteed by the financial activities carried out within the City of London.235 A third reason to be ticked off is the foreign policy support of a transatlantic link, given the wide discontent that had developed by 1970 regarding Nixon’s “benign neglect”.

One of the main suspects is the changeover between Labour and Tory in 1970. However, it must be added that, coming quite unexpectedly, Heath’s electoral victory of 1970 gave no time to either civil servants or politicians actually to conceive coherent packages in terms of economic policy.236 Hence, the changeover had the traits of a continuum rather than of a cleavage, as has been noted earlier.

**Leaving Breton Woods: from anathema to dominant strategy**

The main suspect that remains on the list is that, after 1967, substantial theoretical support for a fixed exchange rates system was still in place, and this was accompanied by the fear that giving up sterling’s parity would mean not only abandoning its international role, but the Breton Woods system itself.237 In particular, the City of London defended itself as a financial centre and therefore had a clear interest in that sterling remained an international currency. Even though the government was traditionally more detached from the City’s views than the Bank could be, yet it was not completely insensitive to this theme. Clear evidence that this was the widespread feeling within the Treasury comes from a 1970 discussion, centred on the renewal of the Sterling Agreements, between the Bank’s governor O’Brien, a supporter of fixed exchange rates (and in this not an orthodox monetarist238), his own staff led by Jeremy Morse, and Whitehall officials, where a pivotal role was played by Frank Figures. The strategic problem dealt with was how to phase out the use of sterling as an official reserve currency, so as to accommodate European pressures in this sense, without at the

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228 Ibid.
230 “Note of a Meeting Held at 10 Downing Street at 7.50 p.m. on Monday 16 August 1971”, TNA PREM 15/309, 17 August 1971.
239 See Governor O’Brien’s biography at http://www.oxfordbib.co.uk/view/article/60373/facets-22
same time wrecking Bretton Woods as a whole.\textsuperscript{239} Indeed, after trying to create stability through the SDR scheme, the gold pool and the two-tier gold market, there seemed to be no further step to be taken but to bring about more fundamental reforms such as those advocated by either Triffinites, favourable to a more flexible system,\textsuperscript{240} and Friedmanites, favourable to no system at all.\textsuperscript{241} The contingency planning exercises carried out thus far had led to the contemplation of Operation Hecuba,\textsuperscript{242} a plan developed by Bank officials, which would basically entail a flotation of the British currency in order to prevent the official reserves from running out. Hecuba had been conceived in the wake of the 1967 devaluation, and it was still seen as the most likely way forward in 1969, in an amended version, nicknamed Operation Palmarus.\textsuperscript{243}

The trade-off was, of course, that to abandon sterling’s reserve currency role within Bretton Woods would bring about a loss in the country’s international position, something which was seen as feasible but only in case of real necessity.\textsuperscript{244} The possibility of a further devaluation was taken into consideration, under the label of Operation Baytown, in early 1971.\textsuperscript{245} But a very different decision matrix would come to be in place if Bretton Woods were made to collapse by some other means than the United Kingdom’s own decision to limit its reserve currency role. By the summer of 1971, this hypothesis started to become more and more likely, hence changing the strategic situation and possibly providing Whitehall with a new and Europe-bound dominant strategy, as will be described in more detail during Chapter 5.

5.2. Dismantle the Sterling Area?

Despite being part of an even broader issue connected to the existence of the Commonwealth and to the trade benefits this allegedly brought to the United Kingdom, within Whitehall the debate regarding the Sterling Area - arguably the quintessential example of the need to at least resize the United Kingdom’s international role - looked very similar to the one on the sterling balances that has just been described.

Whitehall, following the same line of thought that was widespread at the Bank, stressed the necessity to dismantle the Sterling Area as a way to loosen the risk of runs on the pound: during times in which the international monetary situation was all but functioning smoothly, this move was seen as a desirable, if not necessary, protection.\textsuperscript{246}

\textit{Replacing the Sterling Area with the EEC}

As the 1960s drew to a close, the civil servants at the Treasury developed some new views on the likelihood that the EEC would actually manage to develop into a monetary area. Despite Mundell’s curse that, lacking labour mobility, the EEC could not be an optimum currency area as it would be under continuous threat of asymmetrical shocks not adjustable with production factors’ mobility,\textsuperscript{247} the developments in Brussels towards the implementation of the plan proposed by Pierre Werner made British policymakers think more seriously about the possibility of accommodating the Gaullist request to phase out preferential trade and monetary agreements before joining the EEC.\textsuperscript{248} After all, leaving the Sterling Area in order to join Europe would accompany the natural shift in the United Kingdom’s trade pattern as it had developed over the previous two decades, with a larger and larger share of trade with EEC countries at the expense of both the Commonwealth and EFTA. Hence, Whitehall’s officials started to show sympathy to the idea of dismantling the Sterling Area despite the slow-down in Commonwealth trade that this would certainly have meant, especially when thinking that another of De Gaulle’s requests was to break the existing preferential tariff system with the Commonwealth countries themselves: a problem which proved to be much more pressing than monetary agreements, as it carried very heavy implications for

\textsuperscript{241} Milton Friedman, "The Role of Monetary Policy", \textit{American Economic Review}, March 1968.
\textsuperscript{243} Ibid., p. 503.
\textsuperscript{244} Ibid, p. 487. See also telegram from Harold Wilson to Sir Dennis Rickett, TNA PREM 13/1854, 14 November 1967.
\textsuperscript{245} Ibid, p. 503.
certain overseas countries, as was the case of New Zealand, most of whose foreign trade was absorbed by the United Kingdom.249

The civil servants' sympathy for EEC integration - which was also due, according to Tony Benn, to the fact that Brussels was "a mandarin's paradise" in that community law was designed by civil servants before being discussed by politicians250 - was, however, not strong enough to argue for an immediate break of the 1968 Basle arrangement which underpinned the Sterling Area251. At any rate, the arrangement was due to expire on 25 September 1971, making this issue a rather urgent one. Not being prepared for a cutting edge decision, Treasury and Bank resolved to push for its renovation. This was still the case as of the summer of 1971, as testified by the internal papers circulated between Bank and Treasury (where Morse and Figgures, respectively, were the main port of call) and showing a positive attitude towards the renovation of the Basle facility.252

5.3. The more political sides: European integration, the domestic economy

Be it due to the already quoted explanation offered by Tony Benn, or be it more simply because of a general, widespread belief that the British economy would be better off if faced by the open foreign competition of the advanced neighbouring economies, at any rate it is true that there was much more Europeanism within Whitehall than there tended to be among politicians.253 It was widely accepted that the overall trade benefits would, within a few years, exceed the sum of the loss of previous trade patterns and the net cost of joining the EEC as was implied by the planned contribution to Brussels' budget which would have been redistributed mainly through the Common Agricultural Policy, typically a sector from which the United Kingdom was not in the position to benefit.

Such a trend towards Europeanism was however limited to certain policy issues, while others were opposed with almost as much strength as the mentioned support. Very few people at the Treasury, for example, would have endorsed the idea that a European central bank should take all decisions of monetary policy for the EEC area.254 At the same time, though, the same people tended to support monetary cooperation among European countries by means of a Werner or Werner-like plan, including maintaining a narrower exchange rate fluctuation range.255 This translated into the fact that support for British entry into the EEC was accompanied by the continuous attempt, during the negotiations, to delay the moment in which decisions should have been taken in the realm of monetary relations.256

In terms of the position towards the use of monetary policy in order to manage the domestic economy - with particular reference to the late 1960s problem of whether the interest rate should have been allowed to check the inflation rate - the Treasury civil servants took a similar position to the Bank in arguing for a more flexible use of rates. Especially when the time came to choose between moving the rates and proposing plans for monetary reform which would have introduced higher flexibility for the exchange rate, Whitehall was leaning much more towards the former solution.257 Unfortunately, this was never the opinion of any of the different Chancellors of the Exchequer during both the Wilson and the Heath cabinets. Until Macleod a certain balance in the management of fiscal and monetary policy ensured that the exchange rate could be


251 "After World War II, which had triggered the development of the sterling overlay that persists to the present, there were numerous opportunities for British - pushed by the United States- to fund the sterling balances. Because of its desire to preserve the international role of sterling and its political objectives (especially India), it decided against such an effort. As a result, its economic and foreign policy faced an additional serious constraint until 1968 and Britain then had to accept highly unfavourable "consolidation" conditions in the Basel arrangements rather than the much better arrangements envisaged right after the war." C. Fred Bergsten, Diplomats of the Dollar: The Economics and Politics of the United States International Monetary Policy, 1996, p.271. Kiyoshi Hirokawa, Britain and European Monetary Cooperation in the 1970s, M.Phil. thesis, University of Cambridge, 2007, p. 89.

defended without bringing about fundamental disequilibria in the remainder of the economy.258 - with the exception of the 1967 devaluation - when Heath’s first Chancellor died suddenly and was replaced by Anthony Barber, the equilibrium started to be more and more challenged.259 In the build-up to the “Barber Boom” of 1972 - basically a Keynesian high public expenditure policy combined with less attention to the balance of payments with the idea that the latter could eventually be rebalanced with an exchange rate adjustment - the new Chancellor continued to defend the stability of interest rates, on the ground that a monetary contraction would slow down an economy whose productivity was already suffering from trade unionist tensions.260

Whitehall’s response could not but accommodate these views - exactly as the Bank itself did - despite remaining very critical of them, as expressed by the tone of the internal memoranda that were circulated as early as the spring of 1971, after only a few months of Barber’s entry into office.261 The floating of the Deutschmark and the Dutch guilder in the late spring made it clear that the international situation was such that Barber’s views might soon leave the United Kingdom with no choice but either a further devaluation or an eventual exchange rate floating. The internal memoranda at Whitehall assumed more gloomy tones. European integration started to be seen as the way out of the damaging effects of the short-term oriented views of politicians, and continued to be seen, as late as of July 1971, as complementary to the “one world” Bretton Woods system, either in its current form or with a reformed, more flexible shape.262 In a sense, this was a conservative position: the EEC would become the watchdog for the domestic economy in a broader world still organized around a Bretton Woods type fixed exchange rates system. As was the case with the two previous technical issues, even the civil servants’ views on these more politicized problems were therefore grounded on the existence of Bretton Woods: as such, they were likely to change as soon as this ground started to collapse.

6. CONCLUSIONS

When one tackles the issue of the international monetary choices the United Kingdom was faced with in 1971, from the evidence shown it looks as if everyone were simply waiting for a casus belli in order to reinforce the country’s overall European policy position. On the one hand party politics, in which positions favourable to European monetary integration coexisted with the firm negative views expressed by anti-marketeers and advocates of free floating, ended up being shaped in such a way that the mainstream view in both parties was favourable to a higher degree of monetary integration with Europe following a disentanglement from the United States and the Bretton Woods system that was centred upon it.

Both at the Bank of England and within the Treasury the general view shifted quite importantly between the mid-1960s and the first half of 1971, the main drivers of such change being the necessity to find a new guarantee for the stability of Britain’s external balance, on both the trade and monetary side. While it had previously been held that Bretton Woods could represent such a guarantee, since the time the pound had been devalued in 1967, the subsequent creation of the gold pool, the introduction of the Special Drawing Rights scheme and the acknowledgement that despite all that, the newly elected US President Nixon had decided with his “benign neglect” not to take responsibility over this state of affairs and to continue the usual deficit policy, new positions started to emerge within the Bank and the Treasury, and the mainstream line even shifted from a protection of sterling’s role towards a possible dismantling of the whole construction, in the perspective of joining the EEC under De Gaulle’s requirement. Since the latter’s retirement, then, the pro-Europe position remained in place. All in all, then, everything was ready for the shift: in this light, the Bank memorandum of 19 July263 and its reflection on the monetary blocs does not come as a surprise, but as the natural development of the events. Within one month of that reasoning, then, the necessary casus belli would arrive; as shall be pointed out in the final chapter of this case study, the United Kingdom’s policy-makers were at that stage ready to take the necessary steps towards Europe.

260 Ibid.
261 Ibid.
262 See for instance letter from Mrs Hedley-Miller to Mr Rawlinson, and attached draft on the international monetary situation, TNA T312/3364, 11 May 1971.
The preparation to a hot summer

The monetary situation over the summer was a continuation of the previous months: international interest rates kept falling, while the British rate was maintained fixed. As a consequence, the current account surplus was even higher than it had been at the beginning of the year. Added to that, three elements contributed to further money inflows.

First, there was a steep rise in the sterling reserves of overseas countries, namely in the Commonwealth, as a consequence of a growing international uncertainty resulting in these countries becoming tendentially willing to accumulate British pounds rather than US dollars.

Second, UK companies continued their practice of borrowing in foreign currency and converting the proceeds into sterling for domestic use, although this phenomenon was smaller than in previous quarters, due to the introduction in January 1971 of partial capital control measures restricting borrowing to medium and longer-term finance.

Third, though sterling-covered interest rates were markedly not convenient, in the light of higher international uncertainty, British banks tended to convert foreign currency assets into sterling.

In total, the surplus in the June quarter amounted to £364 million, of which £126 million was added to the national reserves (reaching £1508 million), while the remainder was used for special swaps with overseas monetary authorities.

Britain also had a debt position with the IMF. The Chancellor of the Exchequer announced that the UK's June 1968 drawing of £256 million would be repaid in August instead of the planned payment in instalments during the following year. The UK's net position with the Fund was still negative because £417 million ($1 billion) had been drawn from the Fund under the 1969 stand-by arrangement and still had to be repaid.

As the summer came, the macroeconomic picture of Britain was clearly one of instability. Everything seemed to have changed in the framework: all domestic variables were deteriorating at the same time; economic policy-makers, both in the central bank and in the government, perceived a threat coming from abroad, in the form of an unsustainable gold price, an unsustainable growth in magnitude of capital inflows, and an unsustainable mismatch in interest rates; on top of that, they found themselves with their hands tied because of the apparent inability to impose effective policy measures to the whole Sterling Area.

It is time to try to get an understanding of what options were in the mind of British policy-makers at the time. As is known, in a few months the Bretton Woods system was brought to collapse by the US President's decision to close the gold window, which would totally change the scenario as well as the options available to policy-makers.

British strategists and their American counterparts

It must be noted that in one of the best histories of Bretton Woods, Robert Solomon himself wrote about various countries thinking of floating their currency, or widening the floating range around their peg - especially after the crisis of May 1971 - but he never mentioned that these countries might have gained awareness of the fact that the choice made by the United States might be that of simply closing the gold window. In an interesting version of this story, compiled in 1983, Joanne Gowa gathered evidence as to how large the role of public opinion management was in shaping the course of events, rather than actual economic advice. In an anonymous interview reported by Gowa, a member of the US Council of Economic Advisors observed:

"It would be very easy . . . to say the fixed rate system is at an end, so we'll go on to a floating rate system. But you get down there [to Washington], and you suddenly start to face operational questions [...] You suddenly see that this isn't an advanced seminar in international finance where you debate the merits of floating versus fixed rates. You've got a hell of a lot of tactical, important questions that you've got to have answers to."

However, even if it is possible to hold that a struggle between economic theorists and politicians might have been shaped along the lines of the concrete feasibility of certain choices, their timing and so on, it does not seem possible to affirm that, as a consequence of this behaviour, an economic strategy was not in place. Even if on the

265 Ibid.
267 Ibid., p. 120.
US side the choice of the tool might have been one of contingency planning, definitely the strategy had been orchestrated in advance. What is missing in Gowa, too, is the consideration that other countries might have predicted the whole course of events.

This turned out to be true for the United Kingdom, where archival evidence showed, in an unambiguous way, that the picture was slightly different from one of dependence on public opinion and contingency. Not only had officials in the United Kingdom considered - as other national officials had done all over Europe, and as is possibly accepted by the existing literature - that the United States would sooner or later have taken this decision; rather, they were precisely waiting for something like that. Namely, they were totally aware of what the US economic strategy was - as was pointed out, they were in contact with US officials and they imagined the quadrangular struggle between Federal Reserve, White House, Treasury, Council of Economic Advisers, and they were simply trying to predict the outcome of this internal battle in order to determine what tool would have been adopted to solve the blatant deficit problem. According to documents related to the months of July and August 1971, they predicted the timing of its adoption, so that the date of mid-August 1971 did not surprise them at all. As a matter of fact, a secret exchange of memoranda between the officials at the Bank and the Treasury was already in place in mid-July 1971, and the possibility that the US did something like cutting convertibility was considered a matter of weeks rather than months.

In this context, the officials working on the issue at the Treasury and at the Bank had to answer a set of questions, clearly reported in the memoranda. Among these questions, the most important was one of long-term strategy: "The first question is which bloc should we join." Referring to the EEC and the dollar monetary areas, Bank of England official Sangster was addressing two of his colleagues, Henry Hallett and Executive Director Jeremy Morse, on 19 July 1971, which is to say, less than one month before Nixon's famous speech. One could not say these people were unaware of how this issue was dealt with in the United States, and the whole memorandum is an extraordinary piece of historical evidence as to what type of strategic thinking was being developed by at least a group of British economic policy-makers at the time about the issue of monetary blocs. The memo reported what was a temptation in the behaviour of the time:

We could all pretend that nothing significant had happened, that effectively the Americans went off gold years ago and that we could continue as at present. This, however, is most unlikely: one by one the countries receiving dollar inflows could be forced to follow the Germans and the Dutch.

And the relevance of these words becomes even more evident if one considers how the same report goes on, outlining a strategic consequence which is central to the understanding of the issue: in those times, Britain had to assess the feasibility to join the EEC, as well as its attitude towards the whole project of monetary integration launched by Pierre Werner in his plan of 1969. Namely, the possible attitudes were: join and be an enthusiastic promoter of European cooperation; join and behave in a realist way, exploiting the EEC as much as possible and contributing as little as possible; join and try to orchestrate a sabotage in favour of ties with countries belonging to the American bloc. In terms of monetary regime, the memorandum reached the conclusion that "an American float could quickly reunite the E.E.C. countries. We are therefore likely to have a world breaking up into at least two blocs - an E.E.C. one and a dollar one - with perhaps one or two countries like Canada floating against both blocs [...]."

In this way, from the monetary side the Bank reached the same conclusion that most politicians, especially in the government, had reached due to considerations of a more political nature. Within the central bank and the government, nobody was acting out of ideology, and both institutions knew that the last word would be Heath's, however difficult Whitehall would find it to follow the decision. Likewise, O'Brien would have accepted this choice in good order, and the Labour party, despite complaining about certain aspects of the EEC negotiations, would ultimately have welcomed a European changeover in the monetary setting too.

268 Bank of England Archive, C 43/325. Also TNA T312/3364.
269 Neale to Ryrie, "International Monetary Problems", secret memorandum, TNA T312/3412, 3-4, 21 July 1971.

271 ibid.
272 ibid.
Further open questions looming ahead

The situation left many other open questions which are then analyzed one by one in the memorandum, giving them a light of inevitability: the gold market problem, with the scarcity of UK reserves in gold and SDRs; the necessity for protection of the $4.1 billion held by the UK as reserves; the possibility that countries turned to other currencies in order to keep their own reserves if the US were to go off gold within a few weeks, and in this light, the importance of securing the renewal of sterling agreements; and of course, the fact that a break-up of the Bretton Woods agreements would make the eurodollar market shrink slightly, with an upward trends in eurodollar rates.

All in all, British policy-makers faced the forthcoming August measures with much more consciousness than their American counterparts had predicted. Bretton Woods was collapsing, and the snake was clearly seen as its alternative rather than its complement. A good part of such consciousness was possible thanks to the civil servants at Whitehall and the Bank officials, who were deeply involved with the Bretton Woods monetary events, while party politics only dealt with monetary issues in the context of the choices regarding the Sterling Area and the EEC. As will emerge more clearly in Chapter 5, both of these strands would push towards the shift in perspective from a “one world” to a “two worlds” system, despite the latter being shaped rather differently from the one promoted by George Bolton back in the 1950s. Before looking at that, however, it is worth spending some words on what was happening outside the policy-making circles, a theme that will be dealt with during the next chapter.

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CHAPTER 4

PRESSURE GROUPS AND MONETARY POLICY-MAKING IN THE UNITED KINGDOM BEFORE THE COLLAPSE OF BRETTON WOODS

Eldon Griffiths - Since Mr Victor Feather and not the Prime Minister now seems to be in charge of issuing dog licences, would it not be better for the Prime Minister to make his broadcast not from No. 10 Downing Street but from TUC headquarters?

- Hansard, 19 June 1969

1. PRESSURE GROUPS IN POST-WAR BRITAIN: OLD TRADITIONS AND NEW TRENDS

Perhaps the most direct consequence of the collective nature of policy-making in modern democracies is that the boundaries of such process become rather indistinct. The bottom line is that, in spite of institutions, sometimes private entities outside government or political parties end up influencing policy-making; however, aiming at a complete picture of these patterns would be as useless as drawing a real-scale map. Historical narrative needs to be synthetic, even if this does not necessarily mean the underlying research has not been analytical. In this light, only three types of pressure groups are worth mentioning: trade unions in the first place; then business associations; and finally the financial institutions of the City of London. Each of these groups influenced the choices regarding the monetary regime through different channels and with a different leverage. Sometimes, their claims were mediated by party politics - as was the case of the Confederation of British Industry (CBI)\(^1\) within the Conservative

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\(^1\) The CBI was formed in 1965 out of the merger of the Federation of British Industry, FBI, the British Employers' Confederation, and the National Association of British Manufacturers.
2. TRADE UNIONS AND POLITICAL INFLUENCE

In the 1960s and early 1970s many European countries recorded a shift in the domestic dynamics of economic policy-making. Side by side with governments and central banks, trade unions were one of the most notable new actors that came into play. By the end of the period dealt with in this chapter, on the occasion of the Labour government’s White Paper *In Place of Strife* of 1969 and of the Conservative government’s Industrial Relations Act of 1971, the British trade union movement reacted with a period of massive strikes, which came to be commonly accepted as the quintessential examples of the unions’ new power.

2.1. What did trade unions have to say on monetary policy?

The way trade unions used to look at monetary policy-making was, naturally, dependent on the point of view from which this type of institutions looked at economic policy in general, that is, in search of solutions politically acceptable to the working class. The first element to be taken into account is therefore the trade-off between inflation and unemployment, whose relevance in terms of economic theory dates back to Keynes. In the eyes of trade unions, the issue of inflation translated into the question as to where this phenomenon came from. Given that the two most accredited suspects were the international monetary system, and trade unions themselves - as a consequence of their wage claims and strikes - it is easy to guess that the problem occupied a rather high position in the agenda.

The second monetary concern was the exchange rate regime itself: the working class had an implicit preference for price predictability, as wages tended to be stickier than prices and would therefore risk more in a volatile environment of floating exchange rates.

The final question was foreign trade, an issue whose debate was catalyzed by the possible opening towards Europe, as well as by the acknowledgement of an historical trend which was actually shifting the country’s trade pattern in that direction. This paved the way for the fears described by the extensive narrative on the United Kingdom’s relative economic decline, which were also shared by trade unions due to the understandable connection between industrial production and the demand for labour.

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2 Besides the United Kingdom, the same is certainly true also for a number of other Western European countries. For instance see Peter Lange, George Ross and Maurizio Vannicelli, *Unions, Change and Crisis: French and Italian Union Strategy and the Political Economy, 1945-1980*, London 1982, pp. 35-55.


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9 The policy now being operated by the TUC discriminates in favour of the lower paid workers who are least able to absorb increases in the cost of living." TUC Archive, MSS.292B 4053, TUC Press and Publications Department, press release, "Statement on devaluation", 22 November 1967, p.2. The problem here was to evaluate whether such volatility would have been greater than imposing the US inflation via the fixed parities of the gold exchange standard. Trades Union Congress, Britain and the EEC - Report of the TUC General Council to the 102nd Annual Trades Union Congress, Blackpool 1971, pp. 13-14. Britain and Europe since 1945, microfiche collection, Brighton: The Harvester Press, 1973, file 013.285, n.77-78.


2.2. Inflation and unemployment in the aftermath of the 1967 devaluation

As has been pointed out in Chapter 2, during the months after the 1967 devaluation, the Wilson government launched a plan which aimed to cut expenditure by some £700 million during the financial year, a measure that betrayed a certain disillusionment about the traditional Keynesian rule. By late 1967, the trade union movement, too, had started to investigate possible solutions to the problem of inflation. The research department of the TUC had extensively focused on devaluation, accepting that it had been necessary in order to defend the national economy; most importantly, the TUC’s General Council declared they “[would] not regard increases in prices arising from the reduced external purchasing power of the £ as constituting in themselves justification for increases in wages.” In other words, the TUC made a pledge not to exploit the higher domestic prices that would follow devaluation in order to make new wage claims, as this would create a dreadful spiral of inflation.

On this occasion, however, the TUC found itself closer to the CBI than to the government: in the preparatory memorandum to a meeting that took place on 27 November 1967, TUC officials acknowledged the existence of a “TUC-CBI axis” which would not be broken by the situation. Indeed, both institutions believed devaluation was not the final solution to the problem: for the CBI, “[...] the measures announced by the Government to support devaluation are unlikely alone to achieve the changes required”, while Frank Cousins, in a late November meeting between the TUC and the Secretary of State for Economic Affairs, made it clear that “even when production did go ahead, it would not be true of all categories of workers that there would automatically be the opportunity for increased earnings through higher overtime.”

These positions ruled out at least the option of using the fiscal lever: as CBI put it, “the reinforcement of the existing measures by heavy taxation increases are likely to be a depressant to all parts of the community and not a means of giving confidence.” As regards the possibility of running a Keynesian deficit, which in practice implied playing a sort of “benign neglect” with respect to the balance of payments and thereby risking a forced float, it must be noted that it was not even considered. Trade union analysts still showed belief in fixed exchange rates, mainly due to the attitude just described.

Such belief, however, was oriented towards a reform of Bretton Woods which included the implementation of SDR as a “fully fledged international reserve asset”; such currency would replace not only the dollar but, most notably, it would also reduce the sterling balances issue, thereby freeing Britain’s balance of payments from this constraint, that “produces a result which is more detrimental to economic growth and employment in Britain than is the corresponding result which balance of payments deficits produce in other countries.”

At any rate, the debate that had opened between trade unions and government over a possible devaluation - which after all was a way to defend Britain’s money at the expense of the real economy - gave way to a new attitude by the TUC, which started to develop its own ideas regarding the correct conduct of monetary policy, in search for the option that would have best suited the working class. As correctly pointed out in a memorandum of late 1968,

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12 "It is [...] necessary to re-examine Britain’s external relationships and the role of sterling in the world. All that devaluation has bought is time in which these more fundamental readjustments can be made." TUC Archive, MSS.292B 405/3, n.409, "Devaluation - its aims and implications", 1 December 1967, p.3.
15 At the time, Frank Cousins was a member of the General Council of the TUC, and the General Secretary of the Transport and General workers’ Union, TGWU. He had been involved in the Wilson government as the Minister of Technology from 1964 to 1966.
The current crisis in international monetary arrangements follows the gold crisis in March and gives further evidence in support of the General Council's view that international monetary reform is of great urgency. The objectives of reform must be that expansion and full employment determine international monetary arrangements, not vice versa.21

Which international reform, then, should be adopted? In order to address this question one needs to answer a preliminary one: what was the union's driver, full employment or the wage level? Indeed, the existence of a debate on the Phillips trade-off was surely seen as a reason for the unions to support a regime change, but not any change. On the one hand, unemployment was estimated at around 2.4% - which was seen as high for the British standards of the time22 - and this was definitely a source of worry. On the other hand inflation, as has been pointed out, was expected to rise in 1968 as a consequence of devaluation,23 but that rise would not have produced employment effects as it would have been stimulated by monetary rather than real factors.

As a consequence, the unions were unanimously aligned on a no-go line on any policy package that would, explicitly or implicitly, lower the value of current wages.24 Hence, the only visible solution at the time was a deflationary package operated through a cut in public expenditure: that is, the one which was eventually put in place.

2.3. 1968 and the uncertainties about exchange rates fixity

The possible diversion of resources from the defence of the exchange rate to the defence of full employment and the price level through a reform of Bretton Woods was not yet taken into consideration. As said, a debate was in place as to whether inflation was caused by the unions' wage claims or the US deficit, and international monetary reform in this context meant that something had to be done so that domestic inflation be useful to the unemployment level as opposed to being a sunk cost to the economy. In terms of exchange rates, already in January 1968, on the occasion of the publication of a Treasury Memorandum on the Special Drawing Rights scheme, the economic analysis of the TUC was that there was a tangible "fear that the United States is exporting inflation to Europe by its 'unsound' monetary policies. As soon as this fear continues it is doubtful whether [the French] will agree to see the [Special Drawing Rights] scheme start."25

The TUC was quite supportive of the scheme itself as a way to save the idea of a fixed exchange rates system and at the same time disconnect it from the US domestic economic policy which was being blamed for inflation.26

Moreover, as soon as evidence spread of the US economy's troubles, as well as the belief that such troubles created a spill-over of inflation abroad, the ICFTU too had started to promote the necessity of an international monetary reform,27 and the TUC had endorsed its line in the direction of a relaxation of the exchange rate rules, consequently developing the view that

23 "It was inevitable that some prices would go up, though some of Britain's food suppliers, including Denmark and Ireland, were not devaluing. The Government expected the rise in the cost of living to be 2% to 3% in the course of 1968." TUC Archive, MSS.292B 405/3, Trades Union Congress, DL/ET/DW, meeting report, "Devaluation and the Economic Position - Report of meeting between the Finance and General Purposes Committee and Secretary of State for Economic Affairs and the Minister of Labour held at the DEA, Storeys Gate, London SW1 on Monday November 20, 1967 at 3.30 p.m.", 22 November 1967, p.3.
24 Even so, by late 1968 the TUC was not so happy with the developments of inflation and the governmental response, for exactly unemployment-related reasons: "The measures introduced by the Government will lead to a continuation of the excessively high level of unemployment which has now lasted for more than two years." Moreover, a purchasing power problem was envisaged: "The best estimate that can be made of the effects of these indirect tax increases on the cost of living is that following the April Budget, which increased the cost of living by about 3½ per cent, these further measures will have a further effect of 1½ per cent." TUC Archive, MSS.292B 405/3, 159.
26 "The other conclusions of the memorandum would be shared by the General Council and in particular the references to the private portfolio of £3,000 million and the need to develop the proposed drawing rights into a fully fledged international reserve asset." TUC Archive, MSS.292B 405/3, Trades Union Congress, DL/ET, memorandum, "The Sterling System - Comment on note by the Director-General", 28 December 1967.
27 "The governing bodies of the ICFTU have repeatedly emphasised the need for a thorough and effective international monetary reform based on a mechanism that would at all times guarantee sufficient international liquidity so as to facilitate and accelerate economic growth in all countries, both developed and developing. This mechanism should also permit, in case of balance of payments difficulties, to restore the equilibrium without resorting to general deflationary or protectionist measures." TUC Archive, MSS.292B 405/3, ICFTU, press release, "Statement on the International Monetary Situation", 2 December 1968.
Leaving aside floating rates, which would create considerable uncertainty for traders, there are several possible alternative ways of adjusting the exchange parity adjustment procedure. One possibility is to widen the present 1 per cent bracket on either side of parity: this would help to damp down speculation. Another possibility is the introduction of arrangements which would permit gradual and limited changes in parities over a period of time and avoid sudden revaluations. The main aim should be to provide a means by which necessary adjustments can be made to exchange rates in an orderly fashion.

Hence, the TUC leadership still ruled out the idea that Britain should float the pound; this position might have influenced the governmental view as to what policy solution would have been best at that stage. Indeed, as of late 1968 open discussion was carried out on the subject of international monetary reform between the TUC and the Government, during which the latter was credited by the former to have “shown a progressive attitude to international monetary reform.”

On its side, within the government itself - as also witnessed by the explorations in the area of floating rates of the Hecuba and Priam plans - the possibility of a non-violent reform of Breton Woods had started to be accepted, as is also reported by Oliver and Hamilton.

2.4. The growing awareness of changing trade patterns

The final element of the analytical triad used so far was the trade argument: by 1968, not only was trade with the Sterling Area countries seen as important but, due to the long term shift of British trade out of the Commonwealth and towards European countries, the possibility of coordination with the policies carried out on the continent started to be seen as a wiser and wiser option. If on the one hand this reasoning led to

consideration of a possible entry of Britain into the EEC - a case made by the Wilson government since 1966 but constantly opposed by the TUC - on the other hand a more simple concept came to be accepted: if not a common market, economic wisdom would at least suggest that the United Kingdom’s economic policies should be shaped with an eye to what continental countries, belonging to either EEC and EFTA, were doing. After all, most of them were struggling with exactly the same problem as Britain: alleged import of inflation, high unemployment, and growing difficulties in keeping the Breton Woods straitjacket, as was clearly witnessed by the emergence of the gold pool, the Special Drawing Rights scheme, the Basle Agreement and so forth - all attempts at avoiding Robert Triffin’s early curse that the gold exchange standard would fail.

Consequential to these views by the TUC was that the United Kingdom should engage in policies aimed at calming down the domestic economy, fostering imports and entangling with Europe.

As to floating, it is possible that the unions’ opposition played an important role in preventing the Treasury from considering this possibility, even when the time came to develop the contingency plans Hecuba and Priam. The latter, indeed, were only worked out as a solution of last resort in case all other options had failed, namely the enforcement of a partial Operation Brustus under the cover of the Basle Agreement.

The obvious bone of contention, which still remained to be addressed as of the late 1960s, was integration at a regional level, and specifically with the EEC. As a leftover of the debate described, it would only be in the early 1970s that the issue would acquire

37 See Chapter 2 for a more detailed description of these plans.
a central role in terms of the international policy choices of the country. Such a late rise in importance was due to two external reasons taking place almost at the same time: on the one hand the retirement of President De Gaulle, and on the other hand the crisis of the Bretton Woods fixed parities, for reasons not due to the United Kingdom's behaviour, which brought to surface the sterling balances issue, on which - as has been seen - the TUC General Council promoted a no-go line, supporting SDR as an alternative to sterling's reserve currency role: "The sterling system cannot be discussed without raising the possibility that the sterling area as such may at some stage have to be dismantled". By the beginning of the 1970s, given the leverage acquired by British trade unionism in this field, one would expect the subsequent debate to reproduce the high relative weight that the TUC had acquired on the government's monetary choices.

3. BUSINESS ASSOCIATIONS

Moving from trade unions to the business associations, the most evident difference was the higher internationalism of the latter, which could be said to stem from the relatively high degree of internationalization of British business. This perspective was most likely to determine the business associations' positions in the ongoing debate regarding European integration, one which was closely intertwined with the possible phasing out of certain, if not all, Commonwealth preferential trade and monetary agreements. In turn, given the importance of the latter institution in every issue regarding the country's international trade, such debate was most likely to have a determining impact on the position of business associations as to what the best monetary regime would be, making it increase in importance among the interests that such associations tended to represent among the wide array of different views that existed in the business world. Finally, such position on the monetary regime would only produce a policy outcome insofar as business associations could have a say on the government's policies, hence the importance of looking at the way policies ended up being influenced by the lobbying activity carried out by business associations.

The main business associations involved in the monetary debate were two: the already introduced CBI, and the Commonwealth Industries Association (CIA). The structure of business pressure groups did not stem from a coherent "division of labour" among associations: the CBI was functional, the CIA grouped business with a specific international trade focus. The importance of each of them was due to the peculiarity of the country's history: the Federation of British Industry (FBI), precursor of the CBI, had been one of the oldest business associations in the world, reflecting the United Kingdom's position of "first comer" in the industrialization of the economy; the CIA, despite its more marginal role in the overall British economy, reflected the country's former role as the centre of an empire.

3.1. From the internationalization of business to the position on the EEC debate

Starting from the first element of the described pattern, despite being more internationalized than most continental European countries, the British economy had not traditionally been integrated with these geographically closer counterparts in terms of trade relations. It exported and imported most commodities from its former empire presently the Commonwealth. Hence, as of the early EEC years, this type of internationalization could not yet determine a development favourable to integration within the EEC unless a major change in trade patterns took place. The change in trade figures which took place in the late 1950s, leading to the final superiority that EEC

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46 Ibid.
import-export activities achieved in 1962 relative to the Commonwealth,47 marked the shift in the attitude of most large British companies, which started to look favourably upon a potential British engagement with the EEC.48 Smaller companies, despite the fact that some would have benefited from the removal of trade barriers towards the EEC, were still fearing continental competition and remained therefore sceptical on the issue of European integration.49 This led the largest association, CBI - in which small businesses enjoyed a high leverage50 - to remain more sceptical than the large companies;51 this was not an easy position to deal with on the side of the governmental Board of Trade throughout the 1960s.52 Adding up to this, the CIA always remained firmly opposed to any shift towards Europe, for the most obvious reasons, and used its parliamentary influence in order to oppose EEC entry;53 this was of course more a problem for the Tories than for Labour, given that ten MPs from the former party represented the CIA.54

3.2. From the EEC debate to the monetary regime

The lobbying activity undertaken by British business associations towards the government in terms of the debate on the EEC versus the Commonwealth began with the expression of very mild and unclear views during the first steps of the Macmillan government in the late 1950s and early 1960s.55 Such pressures then gained focus and, correspondingly, influence over time during the decade that followed, generating a debate which can be said to be central to the formation of those policies that would lead to what has been described as the most important watershed of British foreign policy56 - that is, the decision to join the EEC in 1973 with all the consequences this would have in terms of trade and monetary relations with the rest of the world - and therefore also becoming a determinant of the business associations’ positions regarding monetary issues.57 Indeed, the supporters of the Commonwealth were also advocates of the concept of the Sterling Area which in turn was very much dependent on the United Kingdom’s prominent role within the Bretton Woods system, while the promoters of European integration possibly accepted the idea of monetary integration as an alternative way of providing international monetary stability.58 The latter reasoning is especially true if one considers that the organized business, as is natural, promoted its own vested interests, which in the international realm were obviously of a trade nature. Hence, the problem of the monetary regime coincided with that of trade, and the interest of the British business was to get guarantees on monetary stability with those countries with which the country traded the most.

It does not therefore come as a surprise that most of the lobbying put in place by the associations was oriented towards the Board of Trade rather than towards any other governmental department or agency.59 The CBI was the association which made most use of this channel.60 On the other hand, the CIA exercised a large degree of its influence through Parliament, thanks to its being represented by its ten Conservative MPs.61

To complicate the picture, these two different patterns of political influence also represented two different views regarding the international monetary regime, which possibly became three if one considers that the CBI's views were split between the

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50 Ibid.
55 "Large firms had become firmly in favour, together with leading industrial spokesmen such as Lord Chandos, head of the Institute of Directors. The Federation of British Industries, due to its consensual membership, failed to actively promote membership, but the major industrial leaders made their position clear." Zig Layton-Henry (ed.), Conservative Party Politics, London: Macmillan, 1980, p. 99.
60 Ibid.
specific accent on them in its initial phase: indeed, the subject was going to become a major one only since the late 1960s, which is to say, when the international monetary developments started to show that Bretton Woods would not survive forever.

3.3. From the monetary regime to the impact on policy up to the early 1970s

The perception that Bretton Woods was feeling sick was highlighted by the British pound’s devaluation of 1967.67 From that point onwards, many elements in the domestic as well as international scene made the British public and policy-makers perceive that something was starting to go wrong.68

This feeling affected the business associations too, which started to consider taking a position on the monetary problem starting from its obvious connection with the theme of European integration.69

As has been described earlier, the main channels through which business associations exerted their influence on policy-making were the Board of Trade and the Parliament. More precisely, the CBI performed three main lobbying functions: the first towards its own members, which in Robert Lieber’s words was “a massive exercise in education and persuasion”;70 secondly towards the government by means of the contact group under Sir William Palmer at the Board of Trade;71 and finally at a European level through the Council of European Industrial Federations (CEIF), the International Chamber of Commerce, the Council of Industrial Federations of EFTA, the EEC Commission, and “bilateral exchanges with German and other industrial federations among the Six”.72 CIA’s parliamentary pressures were mainly oriented towards Conservative MPs, some of whom were CIA members themselves, such as John Biggs-Davidson, whose view on European integration, as of the early 1960s, had been that “the betrayal of British agriculture and Colonial Preference destroyed the Party of Peel.

62 Ibid., p. 95.
71 Ibid., p. 100.
72 Ibid., p. 101.
The betrayal of British agriculture and Commonwealth Preference will destroy the Party of Macmillan.73 None of the associations was in close contact with either the Treasury or the Bank of England,74 which were actually the decision-makers of last resort when it came to monetary relations.

Moreover, the whole situation started to change as the 1970s approached, determining some fundamental changes in the way the business associations themselves conceived their own goals in terms of monetary policy. Once again, as usual, such a shift in views came from, or was translated into, other forms: to speak in terms of exchange rate looked arcane to many, while having a stance on the EEC was much easier to depict.

The introduction of a concrete plan for the implementation of a monetary union by 1980, as approved in the Hague summit of 1969,75 had an impact on large and small companies belonging to the CBI. Some, mainly among the larger ones, continued to look positively towards EEC integration as bringing about market opportunities; some others within the same size group started to feel that the path towards monetary union might have become a way to regionalize trade rather than internationalize it further.76 If the creation of a European currency meant, as the French wished, the breakdown of the Commonwealth preferential scheme and if, as someone started to foresee, the Breton Woods parities were abandoned sooner rather than later, a shrinkage rather than a broadening of international trade would have followed.77 This led some large companies to join the concerns typically expressed by smaller companies which already, as has been pointed out, saw European integration as a threat rather than as an opportunity. The cost-benefit analysis of the trade patterns became the flagship of this group of anti-EEC firms which, by 1970, had become an influential voice within the CBI.78 The main British business association was therefore still debating on both the European issue and on the problem of the best monetary regime, and this unclear situation did not change before mid-1971.79

While CIA’s position was much clearer, a change occurred in it, too, in that the Conservative victory of 1970 brought the Tory MPs belonging to the association to move from the opposition - in which they could easily take an anti-EEC stance - to the parliamentary majority. The difficult relationship between a pro-Europe Conservative government and the anti-Europe Conservative MPs (which extended much further than the CIA representatives, if one only thinks of influential MPs such as Enoch Powell80) would not only create problems within the Cabinet, but also backfire into the CIA itself: how could the association keep its firm stance now that a friendly government, which however thought the opposite as regards the EEC, was in office? The struggle determined a shift towards less firm positions on the European issue, and the acceptance of Britain’s application to the EEC as a matter of fact.81 From 1970 onwards, therefore, CIA’s position acquired more realism, and its main concern became to influence EEC negotiations in a way that Commonwealth interests would not be damaged, rather than opposing the entry of the United Kingdom into the EEC as such.82 In terms of monetary integration, however, the situation remained very open: as it was not perceived as the main bone of contention, the CIA remained favourable to the continuation of the Sterling Area and implicitly of Breton Woods and supported the idea that monetary issues should not be tackled during the negotiations for entry into the EEC.83

Hence, these large business associations looked at the monetary arrangements with Europe as something that might have changed, for good or bad, the general structure of advantages and disadvantages in the international monetary system. One major element upon which the positions were formed was, however, the existence of Breton Woods. The possible future European monetary system was looked at while taking for granted that Breton Woods, either in the current form or in a somewhat reformed way, would

79 Letter from John Whitelorn, CBI to Alec Neale, Treasury, TNA T312/2841, n. 50, 23 September 1971.
83 Ibid., pp. 299–300.
still remain in place. A collapse of the latter would therefore make a difference and, probably, determine some important shifts which would translate into the policy-making realm through the channels described.

4. THE INFLUENCE OF THE CITY AS A PRESSURE GROUP

The City of London was the world’s largest financial centre until replaced in this role in the interwar period by New York. After World War 2, it still maintained a position as runner-up, not only in terms of size of financial activity, but also due to the United Kingdom’s role within the Sterling Area, as well as to the role retained by the British pound as a reserve currency. In addition, as the decades went on, several further developments led the City to reaffirm its leading role on the Eastern side of the Atlantic: the most impressive of these developments being certainly the euro-dollar phenomenon which developed from the early 1960s.

The existence of such a financial hub determined that, by the 1960s, the City enjoyed a tradition of banking and financial services which had been in place for several centuries, and which even predated central banking. The relationship between the Bank of England and City only became a hierarchical one after the Bank of England started to acquire the role of lender of last resort and to monopolize the creation of monetary base, a relatively recent development in the City’s financial history. Consequently, the hierarchical relationship was loose enough to allow the literature to talk about a triangular relationship between Bank, City and Treasury; a triangle in which, of course, each could claim a certain degree of independence and limit the other actors’ freedom of choice.

Indeed, the description of how the triangular relationship among City, central bank and government unfolded over time generated a vast literature, which largely exceeded those that may have existed anywhere else, and which created a sort of path dependency according to which on the side of the Bank a somewhat traditional view was brought forward, and which on the side of the City determined a sort of corporatism that accounted for that unity of intents that made historians describe the City as a somewhat unitary pressure group despite its patent lack of unity, and despite the actual high degree of competition, which existed between its different institutions.

This being the general picture of the relationship between the City and British policymakers, it is easy to reach the conclusion that the City could definitely enjoy a fast track towards policy-making. The speed of such fast track varied depending on who was in charge of the government: indeed, typically Labour tended to see the City as a burden to the British economy insofar as it concentrated resources in London while somewhat neglecting and impoverishing the rest of the country, typically with the argument that monetary policy ended up reflecting the City’s needs rather than the national interest.


while the Tories were much more open to consider London’s role in keeping the level of capital inflow, and of investment, rather high in the remainder of the country too.95

The pattern described may be applied to the City’s interests in terms of the monetary regime. Basically the elements influencing London’s bankers and financiers’ position on the topic were two, one of which of a monetary kind, the other involving trade.

The monetary element was the traditional defence of the pre-war gold standard, which translated directly into the defence of the post-war order embodied in the Bretton Woods institutions and the Sterling Area.96 Such institutions invested the United Kingdom with a special role in the world monetary system, implicitly guaranteeing London a prominent position as a financial centre, thus calling upon the City and expanding its role.97

As regards trade, for about the same reasons, the City always supported free trade: in E.H.H. Green’s words, “Much of the City’s income came from servicing world trade, and thus the greater volume of world trade the greater the City’s income.”98

It must be noted that the two elements quoted encountered the unambiguous support of the whole financial community: hence, as claimed by Green, the ideas regarding the international monetary regime saw the City act as a de facto unitary pressure group.99

The way the City approached British policy-making along these lines since the late 1960s marked a difference from what the traditional pattern of influence had been. Indeed, the City came to be much more influential since the emergence of the euro-dollar phenomenon which multiplied the size of London-based transactions.100

Secondly, the 1970 Conservative comeback fostered the weight of the City in economic policy-making for the reasons outlined above.101 Thirdly, to a certain extent, London’s centrality in the policy-making debate was highlighted by the inflationary problem that had invested most Western economies since the 1960s: failing fiscal policy and, indeed, incomes policy being unpopular, a tightening of monetary policy might have helped contain inflation; however, this was not possible due to the consequences this would lead to in terms of unemployment and, therefore, trade unionist pressure; a control of financial activity would have been an alternative way to limit inflation as an alternative to playing with the discount rate.102

As was pointed out in the previous chapter, however, the “sterling balances” issue became a matter of concern for British policy-makers insofar as it could theoretically trigger a run on the pound in case of a sudden deterioration of the monetary situation, either domestically or abroad. The existence of the sterling balances themselves was defended by the City as part of Britain’s international role.103 As a consequence, when the debate around the country’s accession to the EEC came out, on top of the lack of sympathy for the notion of a common external tariff (as part of the broader free trade ideas), a part of the City started to see the European experience as a potential threat to its own independence.104 Moreover, if a common currency were to be introduced, the monetary policy of such currency would be centralized and the City might lose a significant part of the benefits of the special relationship it had with the Bank of England and the British governmental authorities.105 At the same time, obviously, the positive sides of EEC accession emerged in that London would probably impose itself as Europe’s main financial hub, in a sort of “first comer” pattern: moreover, if this would be especially true in case a single currency were introduced, even an agreement towards the fixation of exchange rates in a Werner Plan-like way, coupled with higher monetary cooperation that would make intra-EEC transactions and capital flows easier,

99 Ibid.
103 Ibid., p. 160.
104 “John Prideaux, chairman of the National Westminster Bank, [...] feared that U.K. banks would become subject to more formal supervision, which might result in the loss of some of the trading advantages which they enjoy vis-à-vis Europe as a product of the present liberal regime.” “The City and Europe”, Bank of England Archive, SA10035, 13 December 1971, p.1.
105 Ibid., p. 1. See also the opposite position expressed by Pringle, from the Committee on Invisible Exports, in the same document, p.3.
would almost certainly be a plus rather than a minus in the City’s interests. As of the end of the 1960s, therefore, when it started to become clearer that an EEC-based monetary system might become a substitute rather than a complement of Bretton Woods, the City’s position on the issue remained debated. Three cities existed: a Europe-bound City which saw itself as Europe’s financial hub within a EEC framework; a Bretton Woods-oriented City which would maintain its role of capital exporter into a regional area; and the City of George Bolton’s visionary North Atlantic Free Trade Association which envisaged a regional system centred on the Atlantic as opposed to Europe. By 1970, therefore, different streams of thought divided the City’s position.

At around the same time as the introduction of the SDR scheme, the two-tier gold market, the devaluations-revaluations of other European currencies, and the decision of the EEC to move towards a monetary union made clear that the path might have led to a major monetary changeover in the short to medium run, the Conservative Party led by Edward Heath recorded an unexpected electoral victory. The Tory comeback determined a renewed attention to the City’s claims, especially as far as the criticism to the Keynesian management of the economy was concerned, something which even the Bank’s governor saw with sympathy, were it not for the fact that eventually the Tory policies ended up being at least as Keynesian as those implemented by their predecessors. At any rate, the City felt more taken care of by Heath’s cabinet, and this determined that the positions regarding European policy swung towards the positive during 1970 and 1971.

What remained to deal with was whether the City might play any active role in worsening the inflationary spiral; the typical claim from the trade unionist side being that the City, by catalyzing the government’s efforts in monetary policy, took the latter out of the area for which it should have been used. The problem with these ideas was that, had the government started using discount rates, the outcome in the international stage - organized around fixed exchange rates and relative freedom of capital movements - would have been that massive flows of capital would have followed the government’s choices. One alternative, as Robert Mundell’s “impossible trinity” suggested, was that such monetary policy freedom, in a fixed exchange rates world, should have been backed by capital controls: as is easy to imagine, both the prospect of uncontrolled capital flows due to flexible use of monetary policy under no controls and the elevation of controls themselves were very far from being acceptable options to the City.

Moreover, the other way out of the “trinity” was the exchange rate regime: free monetary policy in a free capital flows environment, but with a flexible exchange rate. However, it must be noted here that this situation was not acceptable to the City either, for the reason well explained by E.H.H. Green in the passage quoted above, that is, much of the City’s activity depended on international trade, and the latter would have suffered from the potential exchange rate instability stemming from flexible rates.

This scenario, which was the state of the art of the City’s views as of the early 1970s, looked like an economic model in which several exogenous variables are taken as constant in order to simplify the explanation. In particular, however, one of these exogenous variables - i.e. that a fixed exchange rates regime was a viable possibility - started to show signals of change as the Nixon presidency made it clear it would do nothing in order to rescue the system.

What would have changed in the City’s reasoning, explained above, had Bretton Woods no longer been an option? Would the City have started exploring its potential interest in a European monetary system, as suggested by the first element discussed here, despite the French attempt at having its role reduced before accession into the EEC? Would it have accepted Europe as a long-term development goal, with the possibility of transforming London into the EEC’s financial centre, as would have been the case if the City had followed the Tory government it sponsored? Or would it, finally, have tried to find a way out of Mundell’s “impossible trinity” which - given that capital movements were too paramount to be given up, and monetary policy would have had to be freed in order to contain social pressure - would have taken the form of developing effective hedging instruments against the savage floating that, it was feared, might have followed the demise of Bretton Woods? All in all, the situation was such that the City’s position would have finally shifted to somewhere else as a consequence of a change in an exogenous variable such as the viability of a worldwide fixed exchange rates system: for instance, a sudden collapse of the existing monetary system which would have urged all actors to position themselves along new preferences as regards the future monetary regime.

5. CONCLUSION

The analysis of the behaviour of the groups and institutions exerting external pressure on economic policy-making in the United Kingdom - or more precisely the synthesis of the theses brought forward by the most influential of them, as has been explained - seem to lead to think of the demise of the Bretton Woods monetary system as a quite significant turning point in many respects. In the rough division, that the chapter suggested, between trade unionism, business associations, and the City’s financial institutions, very different pictures have emerged. On the trade unionist side, the problem was to limit inflationary effects which, by force of the lines the public debate had taken at the time, would be ascribed to the workers’ wage claims as opposed to its real causes. Inflation could be brought about by monetary instability; hence the unionist position against exchange rates floating and favourable to other, alternative actions aimed at saving the balance of payments: either capital controls or calming down the domestic economy on the fiscal side through cuts in public expenditure (as opposed to wage controls). Business associations, which - it must be added - were much more bound to their political ties than trade unionists were, experienced in the early 1970s a period of great hardship as regards their international positions: the CIA remained strongly against European integration for understandable, even if mercantilist, reasons; the CBI was split between the Europeanism of large firms and the reservations of the smaller business. Finally, the City’s position, though debated, was spinning around a very clear interest, that of monetary stability. Fixed exchange rates were fundamental in order to carry out a stable financial activity without the risk that large and savage capital movements be triggered by exchange rates volatility (the same reason, notably, applied to the City’s views on monetary policy, with regard to the preferred interest rates policy); moreover, stable exchange rates would help international trade, hence foster finance too.

All these views took for granted that the Bretton Woods gold exchange standard would remain in place. Sometimes it was even stressed, from all sides, that the United Kingdom’s choices would by no means wreck that system, which these groups saw as either favourable or necessary. However, the early 1970s were also a period in which policy-makers had started to consider rather seriously that Bretton Woods might be wrecked for reasons other than the United Kingdom’s decisions to devalue or float its own currency. Namely, two elements made it clear that a worldwide fixed exchange rates system would not last long: the multiple adjustments to the par values of European currencies, well outside those allowed by the IMF articles of agreement, and Richard Nixon’s behaviour during the first half of his first term of presidency in the United States. Such awareness did not seem to invest every actor immediately and at the same time; certainly civil servants and Bank officials, as well as the parties’ research departments, realized the problem much earlier than pressure groups and public opinion could do. At any rate, the problem had become so blatantly a current issue by 1971 that no one could dispute its centrality on the monetary stage. This chapter has presented it

in the same way it came out at that point, that is, as strictly intertwined with the issue of European integration. In this light, all pressure groups, despite remaining favourable to the fixed rates system, had to somewhat develop a position on what they would support in case Bretton Woods came to an end, and this had very much to do with their respective positions on Europe. The TUC unions were typically suspicious of European integration, despite the fervent Europeanism of some of their most representative leaders, but at the same time their support for stable exchange rates might perhaps lead them to accept European integration in the end. Excluding CIA, whose reasoning had already dominant strategies, the cleavage internal to the CBI between large and small firms might be solved by an exogenous element such as the demise of Bretton Woods by hand of the United States: with large firms already pro-EEC, small firms might have joined that position in the fear that, with no international system at all, trade would become impossible. Finally, the City which was so divided between the possibility of exerting political influence in London as opposed to Brussels in order to have the wanted monetary policy, might actually have swung its own views in case the movement towards Europe had remained the only solution for the international monetary stability it itself so badly needed in order to carry out all of its financial activity.

In conclusion, as 1971 went on, the positions of British pressure groups, coming from the most diverse backgrounds, showed clear signs that a major change in the international monetary regime would have led them to take new positions on the new situation: positions which might well turn their previous ones upside down, depending on the new patterns through which the groups themselves would perceive their own interests would be best defended against the potential odds of an international monetary jungle.

CHAPTER 5

THE UK AFTER THE BREAKDOWN

The previous chapters have shown how monetary policy, and more specifically the choices regarding the international monetary regime, were developed and the ways they were influenced by the most influential actors in the UK during the 1960s and early 1970s. The subjects of the analysis have been the actual makers of policies: namely the Wilson governments - with prominent figures such as Jenkins and Callaghan - as well as the Conservative party of Heath, Barber, Rippon and its other people and departments; the Bank of England and its staff under the governorship of Leslie...
O'Brien; the government's side at Whitehall - with Neale and Rawlinson in the frontline - as well as those pressure groups which, despite not being invested with direct responsibilities in making decisions, yet had a profound influence on policy-makers through the most diverse channels: the trade unionist movement and its leaders - Vic Feather, Frank Cousins to name just the most influential - and the various business associations, mainly the CBI or the CIA; and last but not least the City of London, whose role was very well described by George Bolton, a lifelong supporter of London's financial role. The general picture that should have emerged is a broad description of the formation of policy in the country.

The exercise has outlined that, almost invariably, the positions as of the summer of 1971 fell into two broad categories. On the one hand, a wide and diverse group composed of Bank, Whitehall, City and other groups and individuals, agreed on the necessity of a change in the monetary regime, generally one that would be favourable to the creation of a regional monetary system among the countries of Europe. Moreover, almost unambiguously, such attitudes coincided with an open opposition or at least a lack of commitment to the existing Bretton Woods worldwide system, be it expressed directly, or more subtly through a negative position on the role of Britain within the system, mainly reflected in the reserve currency role of sterling. On the other hand, several other institutions, mainly led by the trade unions, would not call for the dismantling of Bretton Woods and, on the contrary, looked at this system as the only viable option in order to guarantee international monetary stability. This position was due to many reasons and came from widely different ideological backgrounds, but in most cases showed a common trait in that it considered the existence of Bretton Woods itself as an exogenous factor, and there were signs that such an attitude towards the international monetary regime, as well as the suggested solutions to its problems, would sensibly shift in case the system was wrecked by factors other than the British policymakers' political will.\footnote{1}

Outside this second broad group - the positions of whose members may be described as potentially swinging - stood minorities that would not change their views depending on changes in the international monetary situation, nor would they ever be ready to support European integration. These minorities were composed of subjects whose interests were clearly oriented somewhere else than Europe, the quintessential example being the CIA, which by definition was supportive of the Sterling Area, of the reserve currency role of sterling, and of all those elements that contributed to keep British foreign policy oriented towards the Commonwealth as opposed to Europe.\footnote{2}

2. THE INTERACTION AS OF THE SUMMER OF 1971

The multiple currency floating of the spring of 1971 opened the way to a troubled summer in terms of international monetary events. With the eyes of the historian,\footnote{3} the economic analyses of the time failed to point out that the complexity of the problems at stake stemmed from its not having a one-size-fits-all solution. Depending on the outcome of international events and domestic choices, someone would have been better off and someone else worse off, whatever the chosen way out. As in every political game, however, each actor had already started to look around in search for possible allies with whom to share views on the desired course of economic policy-making.

The most likely alliance was a trio composed of Bank of England, Whitehall and City of London.\footnote{4} During July 1971 there was a constant exchange of views between Jeremy Morse's division at the Bank and the correspondent Whitehall people - namely Neale and Rawlinson - on the desirability of a phasing out of sterling's reserve currency role,\footnote{5} which was seen as a risky activity at that stage, due to the "sterling balances" problem.\footnote{6} Moreover, the latter problem had caused France and other EEC countries to keep vetoing the possible British entry into the Common Market, which in turn was...


\footnote{3} See for instance Michael Bordo and Harold James, One World Money, Then and Now, NBER Working Paper n.12189, May 2006.


seen by the British government's civil servants as a desirable alternative to the Sterling Area and one which would have fostered British competitiveness, a view shared by the Bank’s governor, who was therefore in favour of a shift towards a European-based monetary bloc, whatever the consequences for the already vulnerable Bretton Woods. At the Treasury, Rawlinson was more cautious on the latter point, showing a willingness to save Bretton Woods, if possible, as long as this did not coincide with the necessity to maintain the second-claim reserve currency role that sterling had had in the post-war order. While in all the attempts that have been made to describe the triangular relationship between Bank, Treasury and City, the link between private finance and government was represented by the Bank, interestingly, in this case it was these streams within the Treasury that best represented the City’s traditional interest, that is to say - failing the possibility to restore a pre-war gold standard - at least to save the integrity of the post-war Bretton Woods system, which provided the UK with a special role in the international money markets, hence fostering the amount of transactions that used London as a financial hub. For the same reason, then, most of the City remained favourable to the free market concept, on both the trade and capital movements side, a position which in principle might have oriented London’s financiers towards the extension of free trade among the countries of Europe, at the same time looked with suspicion at the idea of a common external tariff - not for its being common, but for its being a tariff. On top of that, the special relationship with the government would have been broken, or at least diminished, in case the real decision-making centre had shifted from London to Brussels. Would the City’s institutions have been able to continue, in Brussels - George Bolton wondered - to make the case for a flexible use of monetary policy as opposed to Keynesian demand management? But again, at least on this point, the City had the support of both Bank and Treasury, which after all had always tended to promote monetary policy freedom in opposition to any Keynesian governmental policy, be it anti-cyclical as Labour’s traditional “Stop and Go”, or be it simply an attempt at boosting the economy as in the case of the Macmillan Cabinet (while the quintessential Tory example of it, the “Barber boom” of 1972, was yet to come).

Several of the domestic as well as foreign developments that took place during the first half of Edward Heath’s mandate softened the City’s views and aligned them towards the European bloc view, supported by Bank and Treasury. The domestic part of the story was that the Tory comeback forced the City’s institutions - which formed a homogeneous group in terms of interest, but as has been seen, whose political pressure was not formally channelled - to soften their own positions. Before 1970, Wilson had been an easy target due to Labour’s naturally “incestuous” relationship with trade unions. Indeed, the traditionally Keynesian demand management oriented towards fiscal rather than monetary policy generated attention towards the real rather than the monetary side of the economy, meaning in turn that higher attention was paid to trade unions rather than to financial institutions. But Heath could not be approached with the same critical attitude. Moreover, the Euro-dollar phenomenon had the effect of

19 “It is very important that we should have adequate techniques when the need for re-inflation comes”, TNA PREM 11/4199, Macmillan to Heathcoat Amory, 20 February 1958. “If the chancellor says he wants the base of credit restricted he ought to be able to have a meeting with [the Clearing Banks]; tell them what he wants, and rely upon them to carry it out...”, TNA PREM 11/3756, Macmillan to Lloyd, 1 August 1960.
26 W.M. Clarke, “How Far Does the City Depend on Sterling?”, TNA T312/1491, 21 November 1966.
strengthening London’s position anyway, and by 1970 it had also become very clear that the inflationary trend was a problem due to causes much more complex than simply the trade unions’ attitude. 28

Outside the UK, at the same time, President Nixon was steering the US economic policy in ways that would make the fixed exchange rates no longer an option 29 - hence making it rather pointless to defend a “one-world” system of fixed exchange rates - while the replacement of General De Gaulle with Georges Pompidou in France seemed to open the way to some hope for those who saw London as a future EEC-wide financial hub. 30 All in all, these events had broadened the front of those looking favourably towards the European bloc about which the Bank and Treasury officials were talking in July 1971. 31

The group of those who were ready to convert to Europeanism extended to CBI, or at least to the large companies represented in it, while small businesses tended to be more cautious, despite being dragged by the large ones in many of their political positions. 32 Basically CBI’s lobbying, mainly directed towards the government through the Board of Trade, was positively oriented towards a shift to a EEC monetary system. 33 The industrial world was not all positively oriented, however. The CIA and its parliamentary arm of ten Tory MPs, led by John Biggs-Davison, remained strongly opposed not only to any shift towards Europe, but also to any change in the monetary regime, which was perceived as a threat to the existing preferential treatment of Commonwealth trade. 34


Party Politics

A less clear battlefield was that of political parties. Here, the Tories led by Heath were split between a majority group that was pro-Europe, 35 pro-free trade, 36 pro-monetary reform, 37 and also slightly pro-expansionary fiscal policies, as Anthony Barber was just about to show with the forthcoming “boom” 38 and a minority view led by Enoch Powell and supporting the so-called “social market economy”, 39 basically a more extreme take on the same liberal approach: no to Europe for its being a straitjacket to sovereignty, 40 free trade intended as disentanglement from any international agreement including the EEC, monetary reform in the direction of unregulated free floating, 41 and of course, a “minimum state” with no Keynesian expansion whatsoever. 42 To make the situation even less easy, the sum of these dissidents and the Commonwealth supporters put the government’s parliamentary majority in doubt, with the result that Heath had to undertake “the largest education campaign that has ever been undertaken inside the Conservative party” in order to build a majority on EEC-related votes, including the essential one on accession which was to be given in the autumn of the same year 1971. 43 The quintessential example of the internal dispute within the Conservative Party was then represented by the personal fight, culminating in the summer of the same year, between Enoch Powell and Geoffrey Rippon, with the

35 “When someone inquired whether this was consistent with the former Conservative policy of Anglo-American interdependence practised by Macmillan, Heath eigmatically retorted: ‘I am the leader now’”. Pierre Uri, From Commonwealth to Common Market, Harmondsworth: Penguin, 1968, p.59.
former accusing the government of being keen on accepting EEC entry based upon “Rippon’s surrender terms.”

On the other hand the Labour Party was divided, too: it had been supportive of Europe ever since Wilson’s conversion of 1966, and therefore it found it rather hard to switch to the opposition on this issue, even in those instances in which this might have led the Tory government to fall, as was the case of the parliamentary votes on EEC-related issues. At any rate, the 1971 Tory campaign for entry into the EEC was too much of a golden opportunity to be left aside, and the Labour Party ended up mounting a counter-campaign “against the Tory terms” of entry, led by Denis Healey. What is interesting about this mid-1971 dispute is that it contained monetary elements too. The main argument of the Labour MPs was that the Tory negotiation package involved too much loss of sovereignty for the country, and the case was made that issues such as the reserve currency role of sterling represented the UK’s international prestige and therefore should have been defended against all odds. At the same time and for the same reasons the Sterling Area, representing the post-colonial British relation with the Commonwealth, should not have been given up that easily.

At the same time, other prominent Labour figures - such as Jenkins and Callaghan - took the opportunity of being in opposition - and therefore with a larger degree of freedom - in order to become fervently supportive of European integration. Callaghan was less idealist than Jenkins and an Atlanticist in the beginning. Even if he believed in Churchill’s “three circles” approach - NATO, Commonwealth, with Europe only in third place - he was also able to look at the positive sides of the EEC: the reduction in the productivity gap, the development of the common agricultural policy in ways more favourable to the UK, and last but not least, the idea of reaching continental unity after centuries of war.

The political arena thus showed two internally divided parties, in which dissidents from both sides joined the other party’s mainstream positions. Views favourable to EEC integration, however, had an edge. This helped mainstream Tories and dissident Labour win over the problems represented by the Sterling Area and sterling’s reserve currency role, as described in the previous chapters, as well as to address the issues of EEC membership and of the alleged domestic decline of the UK in ways favourable to a shift of attention towards Europe. Such a shift included monetary issues: in early September 1971, the Labour Committee for Europe hosted an editorial by the General Secretary of the Clerical and Administrative Workers’ Union, Roy Grantham, who expressed the view that EEC entry would “replace stagnation by growth” as it would “break the shackles imposed by our sterling debts which so crippled our growth and undermined Labour’s brave expansion policies”. On the other side of the political spectrum, the Conservative Commonwealth and Overseas Council pointed out that Europe was undoubtedly the new monetary focus towards which the country’s policies should be oriented, as “the trading and reserve roles of sterling have evolved over a period of time as the result of the interplay of historical and economic factors.” Hence, the Council continued, “it would be logical if [...] both roles were gradually taken over by the currencies of Member States as a whole - or by a single Community currency, if ever established”. At the same time, however, Enoch Powell exploited Labour’s “against the Tory terms” campaign in order to create cross-party criticism against EEC entry, which pointed Labour’s main issue of given up sovereignty, and therefore approached the choices regarding the monetary realm by asking Parliament if the British people could “now, or in the next ten years, or in the foreseeable or imaginable future, believe that the people of this country would regard themselves as so much part of an

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electorate comprising 200 to 250 million other electors that they would accept the majority view on taxation, on social policy, on development, on all the matters which are crucial to our political life”. This was obviously a rhetoric question, which Powell addressed himself: “I have to confess that I do not believe such an attitude of mind is foreseeable.”

Pressure groups completing the picture

Curiously, the General Council of the TUC showed a very similar position in its July 1971 report, by arguing that “the removal of the possibility of varying exchange rates between states puts the responsibility for full employment on other measures, such as internal subsidy [...] or favourable treatment to foreign investment”; therefore, the countries of the EEC would find themselves in a “half-way house position, having agreed not to vary the relationships of their currencies, yet lacking the political will to create a unified federal state.”

As has been seen, despite Vic Feather’s orientation towards Europeanism, and despite the latter being backed by several trade union leaders, most of the TUC did not yet look favourably upon the EEC due to the problem of inflation, to a preference for price predictability which was perceived as guaranteed by the existing arrangements (including Bretton Woods), and to the idea that the balance of payments problems had to be addressed via a domestic reduction of public expenditure before resorting to any external remedies such as entangling in new trade agreements. Moreover, a rift existed between the TUC and the City.

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57 Typically, the TUC criticized the City’s overinflated role in the British economy: “the City’s overseas earnings since 1965 have risen from about £210 million to about £480 million in 1969”. Trades Union Congress Archive, MSS/292D, 409/2, Econ C16 8/4, 12 May 1971.

Obviously, the Bank-Treasury-City trio (joined by most industry), the two cross-party blocs, and the TUC, did not represent an integrated decision-making system. The pro-Europe views of the trio encountered the favour of the Heath Cabinet, which joined the pro-Europe business front, with external support from the Labour dissidents. On the other side were Powell, the other Commonwealth supporters, and the TUC: all unfavourable to EEC entry but not forming a common front, for the obvious ideological distance that existed between the former two groups and the trade union movement.

Deep inside the Bank

In terms of monetary views, there remained a rift between the government and the group led by Bank and Whitehall on exchange rates flexibility. As has been pointed out in the relevant chapter, the Bank’s position revolved around its governor’s views. Leslie O’Brien believed that the existing monetary system helped the country retain its own currency’s international role, which gave the UK a certain prestige as well as the economic advantage of hosting an international financial hub in the City of London. It has also been pointed out that he was not the only voice calling for a stable solution to the forthcoming trouble that might have followed a demise of the Bretton Woods system. Among the several options taken into account, it looked as if the most viable alternative - after a possibly unsuccessful but necessary attempt at restoring the Bretton Woods parities in what came to be called a “one world” solution - would be exactly the “snake” proposed by Pierre Werner, with the subsequent creation of a “European bloc”. Secret memoranda in July and August 1971 used this expression extensively, in order to refer to the possibility that Britain would join the “monetary snake” and, eventually, this was the solution preferred by the Bank’s governor and officials, in case a rescue of Bretton Woods failed; this would eventually come to be understood well before the final abandonment of all exchange rate parities in March 1973: to a certain extent, the Bank’s views were already in that line after the discontent that followed the Smithsonian Agreement.

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As of mid-July 1971, several people at the Bank of England were mainly involved in the strategic considerations as to the possibility of a collapse of Bretton Woods and the subsequent necessary measures. Apart from Governor O'Brien, these were John Fforde, Executive Director, and the already mentioned Jeremy Morse, joined by Henry Hallett and J.L. Sangster. All of them had similar but slightly different views on the issues dealt with. The Treasury side - Neale and Rawlinson at this stage - was also advanced in these strategic considerations, having just conceived Operation Baytown on a possible post-collapse free floating.59

O'Brien was the main supporter of the view that Bank rate should be reduced in the light of the situation, and that the April reduction had been a demonstration of how the Bank should behave in this situation. In a memorandum dating 12 August, regarding a meeting between Bank and Treasury top officials, he reviewed the possible actions that Britain might take. The minute reports that his opinion was that "The first measure would probably be to act on Bank Rate even though that was not entirely desirable in terms of domestic policy."60

But he was to change this view in a few hours. In the night of the same day, he had a conversation with the Chancellor and the Prime Minister. The latter agreed with the Chancellor that "[...] we should continue to accept further dollar inflows to a substantial extent before taking any other action. It is difficult to set a precise quantitative limit because much depends on the pace and nature of the inflow. But we could take another $1-1/2 billion next week in the hope that the storm would blow itself out." It must be noted here that such a statement is an evident sign of crisis; no exit strategy was provided.

In the minutes of a meeting which took place the following morning between the Governor and Treasury official Neale, it is reported that O'Brien "was not keen to bring down our interest rate".61 The second official involved in the discussion on the Bank's side, John Fforde, was more keen on making this move. In the meeting of August 12th, he "agreed that a reduction in Bank Rate in advance of exchange control measures was a classic response to the situation and would not be completely inappropriate internally". Fforde's ideal political solutions were very close to what would nowadays be referred to as a technocracy.62

Jeremy Morse had a slightly different view as to what was the correct order of the actions to be taken. He did not even mention the interest rate in a letter to Neale dating 11 August, perhaps including it in the list of unwanted measures by saying that "We are reluctant to take any action which might be regarded as rocking the boat, and in this world wish to be aligned with Germany and Japan rather than with other countries who are currently taking whatever steps they can to cover their US dollar positions."63

In the meeting of August 13th with Neale, the Governor expressed his views on these two measures. After raising the already mentioned issue of the interest rates, he said that Hallett would be talking to the Federal Reserve Bank about the swap line, adding that he was willing to activate it to the maximum amount, as well as to take the second action recommended by Morse, i.e. the Roosa bonds placement.64

Sangster himself added an interesting bit to the debate. He did not attend the quoted meeting between Chancellor, Governor and others, but he did send a memo on 12 August to Hallett in which he made the case that "if sterling appreciated against the US dollar as a result of the US having gone off gold but maintaining that it still had a parity, this would NOT constitute a revaluation of sterling in the context of swap and Roosa bond agreements."65

By this statement, Sangster introduced a further element in the discussion, which is to say, the awareness that the US would imminently go off gold. The Governor

61 Ibid.
64 In general, [Governor O'Brien] is suggesting a package composed of mainly two hedging measures: To ask the Americans to draw all or part of the $2bn. available under the swap line. To place any remaining uncovered funds in Roosa bonds denominated in sterling." Ibid., 13 August 1971.
65 Ibid., 12 August 1971.
discussed it the following day, during the meeting with Neale. He said the Bank "should also need to talk to the Treasury about the implications of a decision to float". This is a rather important statement, as it outlines that the July discussions about economic blocs, mentioned in the previous section, had not involved the Treasury thus far.

The situation described here thus sees a Bank which was, if not fully aware of the consequences of the events, at least aware of what was going on, an awareness which had not been realized by the Americans, and which played an important role in reshaping the debate as to how Britain was behaving in the light of the international economic choices it was facing during the first years of the 1970s.

As a matter of fact, given this analysis of the issues, the Bank concluded that the best solution for Britain, in the event of a breakdown of the parity system, would be to try to defend the international role of sterling, as well as the country’s competitiveness, by trying to keep the parity with the dollar - and at the same time try to access the EEC without making any further commitment to a future monetary union. All in all, it was a chicken game in which Britain’s desired payoff was to obtain a monetary system which would save the current value of the US dollar - as most of the country’s reserves were denominated in this currency - and at the same time not to miss the possible advantages of monetary stability within the European framework. On the one hand, in the short and medium term, the way to reach the first goal was to keep the exchange rate stable; on the other hand, the road towards the second goal was to enter Werner’s monetary snake among the countries of Europe.

At first sight, these findings demonstrate at least three assumptions. First, the international situation of instability due to the US balance of payments deficit was obvious to the point that, on the other side of the Atlantic, all the Bank of England’s officials whose records have been found in the archives almost took it for granted that sooner, rather than later, the system would come to a breakdown. On 26 July, Morse was aware that the US was sitting on top of a Pandora’s box. He circulated the paper written by Sangster on 19 July with a covering letter, in which he presented it as follows:

[the paper] shows what a Pandora’s box such an action might open - an action which the Americans could, at worst, take from weariness with their balance of payments problem or pique at European reproaches. It is true, as C.W.M. would say, that there are prizes to be grasped from such a situation; perhaps an early return to gold by the US at a more tenable rate, perhaps a stronger drive towards economic integration in the enlarged EEC. But things could also go worse than the paper suggests: the EEC could once again fail to hold together, international co-operation and the I.M.F. would collapse and we might be back to bilateralism and a number of blocs all floating against each other. 67

Second, the reading that Governor O’Brien as well as his top officials gave of the situation already showed elements connected to a possible stronger drive towards European integration as a consequence of a collapse of the Bretton Woods fixed parities, at least in the interpretation that the British officials gave of the situation. This agreement, conceived as a measure to hedge against a level of exchange rate risk that might dampen trade within Europe, was the forthcoming “monetary snake”.

Third, rather than simply dealing with short term issues such as the defence of their national position, the British officials at the Bank seemed to be also committed to a longer term, strategic view of how the world would look like within a decade from the collapse of the system. In this context they made a number of considerations about joining one or the other “bloc”. Indeed, Sangster claimed that “in any case an American float could quickly reunite the EEC countries”, a reunification in which it might be possible for European countries, in order to maintain exchange rate stability, to continue to deal in dollars, “but this is very unlikely. Reversion to an E.P.U. like system is more probable with intervention in each others’ currencies”. 68

Another strand of discussion within the Treasury, started around the time the US future moves became somewhat clear to British policy-makers, was the contingency side of the debate as to what the UK’s response should be in the light of the situation. At

68 ibid., 19 July 1971.
The beginning of August, the most striking part of this contingency planning was that as a consequence of US interest rates being lower than in most European countries, dollars were quickly flowing out. Hence, the price of gold in the private market (based in London) also skyrocketed to around $43.50 on 13 August, while the Deutschmark - floating since the spring - had already appreciated 8.5% on the former par value, this revaluation being a benchmark of the size of the pressure on other European currencies, including the British pound.

At the same time as the meeting of 12 August, the Financial Times published an article according to which the situation was still one in which the government would have ostensibly defended the fixed rates system - this is what everyone was expected to say in the system in order to avoid speculative attacks - but this vision, given the analysis just conducted, came clearly more from the civil servant and business side of the policy-making world than from the Cabinet itself. The situation was a copy of what was going on in the US, with Treasury Secretary Connally standing firm in declaring the dollar would not devalue until the Camp David meeting took place on those days. While half of the world was on holiday, then, the main policy-makers on the other side of the Atlantic conceived and implemented the package of policy measures that would break the monetary equilibrium in the rest of the world and - which is of specific interest to the present research - in the British policy-making equilibrium that has just been described and which, as has been pointed out, would only have come out of its impasse in the event of an external measure like the one that took place at the end of that weekend.

3. NIXON’S DECISION AND THE CONSEQUENCES FOR THE UK

Richard Nixon tried to mask the relevance of the suspension of the gold convertibility of the dollar by presenting it as part of a policy package called New Economic Policy - maybe or maybe not knowing that the same name and acronym had been used by Lenin in the 1920s in order to introduce a state-oriented mixed economy in the USSR. Nixon’s package was composed of two other measures: a 90 days wage and price freeze, and a 10% import surcharge. Ostensibly, both of them had been included in the package in order to cope with the possibility that the suspension of convertibility might have an inflationary impact on the American economy. As it happens, the 10% surcharge seemed to address another problem: that is, the American current account deficit, which had become more and more worrisome, especially considering the recent developments of that country’s foreign policy in terms of both defence expenditure and monetary behaviour. The effect of the suspension of gold convertibility was that all financial markets were closed for a week, and at the reopening, most currencies were allowed to float freely and therefore adjust to their actual market value.

Save Bretton Woods? The Sterling Area argument

The first problem to be addressed being contingency, it is natural to find the Bank and Whitehall on the front line. Hence, going back to the analytical categories used in the previous chapters, the more technical issues - sterling’s reserve currency role and the Commonwealth - came first. In a paper addressed to Neale on 17 August, Rawlinson reaffirmed that “political considerations” pushed the UK towards the EEC; while, as far as “economic considerations” were concerned, one had to consider that, once the Smithsonian Agreement had been signed and the floating projects within the EEC had been brought forward, there was little opportunity for the UK to act in a different way than accepting the “unsatisfactory alternative” of trying to stick with Europe.

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74 The Novaya Ekonomicheskaya Politika, NEP, promulgated on 21 March 1921, allowed small businesses to reopen for private profit while the state continued to control banks, foreign trade, and large industries. From http://en.wikipedia.org/wiki/New_Economic_Policy. See also Elisabeth Gaynor Ellis and Anthony Esler, Revolution and Civil War in Russia, Boston: Pearson Prentice Hall, 2007, p. 483.
78 “We want not to prejudice, and if possible to advance, our long term aim of a one world monetary system based on the SDR. This means seeking to preserve the one world system and the organisation of the IMF, and discouraging fragmentation into currency blocs [...] A possible alternative, less satisfactory for the UK, and others but acceptable if necessary, is a small devaluation of the dollar in terms of gold...” See also Eliza...
of the latter point, it must be considered that the reason why the UK Treasury did not like the idea of currency blocs was most probably an attempt at defending sterling’s international role. As a matter of fact, in a “one world” system, sterling might have preserved some of the Sterling Area by renewing the three-year Sterling Agreements which were expiring in September 1971, while in a world divided into currency areas, sterling would not have been the main currency of any area, and would have therefore lost most of its international relevance. As a confirmation of the correctness of this elaboration, a confidential memo regarding the renewal of the Sterling Agreements, compiled by a Mr Mackay on 17 August, affirmed that “In the long term, a floating sterling might be thought less attractive as a currency for reserve holding and trade use. This might lead to a faster run down of sterling than we had thought likely.”

This said, it does not seem that Mr Rawlinson’s position against currency blocs and a European pegging system has to be taken as anything relevant to the ultimate positions of the Treasury on monetary matters, at least for the fact that many of the conditions that had motivated his judgment had changed already one week after the 15th of August, a week during which the EEC Council meeting brought forward the idea to peg European currencies with a margin of 0.75%, as already suggested by the Werner Plan. Moreover, as has been pointed out earlier, officials at the Bank had already moved on from the choice between a “one world” and a bloc-based solution, the new question being rather about which bloc Britain ought to join.

**Politics and the broader theme of European integration**

Obviously, on top of international strategies, the Treasury was also to deal with its domestic audience. In a speech delivered in Leeds on September 9th, Chancellor Barber started off in the following way:

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accompanied by upward moves by the EEC countries and Japan, as before. [...] Another unsatisfactory alternative would be a proposal that the EEC should peg to each other but float in relation to the dollar. This is objectionable both because it conflicts with the one world objective, and because it poses a dilemma for the UK between political considerations, which might point to floating with the EEC, and economic considerations which would point to staying pegged at the present parity with the dollar.” TNA, T 312/3366, no. 47, 17 August 1971.

79 TNA T312/3366, no. 17-18, 17 August 1971.

80 EEC Historical Archive, EN 1509/1, 19 August 1971.


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Next week, nine of the most influential Finance Ministers in the world will be flying in to London for a meeting about the international monetary situation.

It is at any rate a change to find ourselves going through an international monetary crisis with the pound strong, the balance of payments in substantial surplus and the reserves at a record level.

Such a start is totally political. Any economist could have observed he was depicting Britain only through good points. The problems of Britain in 1971 were actually different: the balance of payments surplus created a loss in competitiveness as shown in Figure 12; inflation was high (because of artificially high wages) and so was unemployment (because of industrial stagnation).

**Figure 12. The Swan diagram.**

A balance of payments surplus due to CA implies a rise in the real exchange rate q, which is the (inversed) indicator of the competitiveness of an economy.


This particular way of presenting the economic picture should provide an idea of what type of speech Barber was giving. Moving on to a description of the Treasury (and actually the Government’s) suggested solution, he mentioned the removal of credit controls, and the European way:

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82 TNA T312/3369, 9 September 1971.
For the past 4 years both political parties have been fully agreed on the need to negotiate our entry. [...] My own personal judgment on this question of timing can be simply expressed. If we do not join the Common Market now, we shall never have another chance.83

Given Barber’s own public presentation of Britain’s problems and solutions, two elements must be highlighted. Firstly, the position towards Bretton Woods was that a “new basis for the international system” had to be worked out, which is the opposite from saying that the system had to be saved as it was. Secondly, Europe clearly appeared to be the new international focus of Britain.

*The G10 meeting, the US position, and sterling*

On 15 and 16 September, the UK hosted a Ministerial Meeting of the Group of Ten, aimed at discussing what should be done in order to restore the normal functioning of Bretton Woods. The main question was the dollar outflow, which was addressed in two ways, both regarding actions that the US should take in the near future.

The first issue was the desired improvement in the US balance of payments: Treasury Under-Secretary Volcker had already scared everyone at the Deputies Meeting held in Canada one week earlier, by stating that this improvement would lead to a $13 billion upward swing in the US current account, achieved through the trade balance, which in turn would have meant a downward swing in the trade balance of all other countries trading with the US and here the question was of course whether the system would have benefited more from a US in surplus (thus no more capital flight) and, in this case, how large this surplus should have been, considering that the present situation was a deficit of $4 billion, and the upward swing would have changed the figures to a $9 billion surplus.

The second issue was whether the US should maintain the 10% tariff on imports. Such a surcharge curbed capital movements, and therefore, given the already mentioned “impossible trinity”, to question its appropriateness was exactly the same as questioning whether there should be a fixed rates system or not. Indeed, monetary policy was still needed by many countries - including, clearly, the UK - in order to manage the yet unresolved novelties of these years: stagflation, social unrest and so on. What remained were capital movements and floating rates, one of which had to be given up. Thus, maintaining the import tariff would perhaps make it feasible to have fixed rates, while getting rid of them would almost automatically mean to switch to general floating.

But a restoration of fixed rates would only have been possible through a dollar devaluation in terms of gold, which would have made it possible to restore the official convertibility of the greenback. Robert Solomon reported that “No one questioned the desirability of a return to a system of ‘fixed parities’”84 and this gave a partial answer to at least the latter point, the former remaining open as, in the words of French President Pompidou at a press conference several days later, “I am convinced that the desire to reach a conclusion at any cost in the near future would lead the partners of the US to exorbitant concessions that in the end would finally make a balanced solution impossible.”85

In line with all that has been said regarding the strategic thinking of the UK, the Treasury staff had already built quite a precise picture of short and long-term planning, so that the Chancellor might reach the meeting with a clear set of objectives. In Mrs Hedley-Miller’s words on 9 September, sending to Neale and Rawlinson a summary for the Chancellor, “the UK’s main objectives have been gone over a good deal, and can now be presented in summary form.”86

The summary divided the Treasury’s objectives into two sets: “main” and “intermediate” goals. The “main” goals descended from two priorities. The first one was currency stability, and this was the Treasury’s position in relation to the US and the

83 Ibid., 9 September 1971.
86 TNA T312/3369, 9 September 1971.
EEC. The second main goal specified that restoration of stability excluded the possibility of a restoration of Bretton Woods for the time to come.

These thoughts referred to the classic Keynesian idea of an international currency, but there seems to be enough evidence that the Treasury had not decided to go back to Keynes; rather, it simply used this argument as a way to support the demise of Bretton Woods. The time was favourable to shift to something new and less related to the dollar; Britain’s growing trade with the EEC made it sensible to think that the international anchor for the stability of sterling might become the EEC area - more precisely, the projects for monetary union started with the Werner Plan in 1970.

In Whitehall’s words, “The IMF’s position must be respected and preserved. This is partly politics: not only the LDCs but ‘middle’ countries like Australia must not feel frozen out. It is partly practical: the IMF is an experienced and expert body in the mechanics of running a world payments system and will be needed in this role.” At the same time, European integration was seen as a stage towards this goal, as “the realities of the situation [demanded] that in the early stages study should take place in restricted groups. The Six [had] their own machinery, and the UK should [have] become associated with this.”

This getting closer to “the Six” - the EEC - is not surprising, given that the same attitude could be found at the Bank of England, and it reinforces the idea that at least since July 1971 most of Britain’s policy-makers had shifted their monetary strategy towards the formation of a potential EEC bloc - which is also the reason why the Treasury was so concerned about the pound’s exchange rate relative to “EEC currencies”, clearly meaning the French franc and the Deutschemark.

More evidence comes from the unveiling of the UK strategy that emerges by comparing these ideas with those contained in the guidance notes for the UK delegation to the consultative assembly of the Council of Europe, dating the same day - 9 September - and having been compiled by Mrs Gilmore, a Treasury official from Rawlinson’s unit. The tone regarding the issue of a Bretton Woods demise was presented in a slightly different way:

HMG by no means rules out long term changes in the international monetary system but feels that they should be more in the direction of a return to the Bretton Woods system as originally conceived than of a new system.

9. Such future arrangements could include a widened and adapted role for the SDR. [...] Implicitly, the paper recognises this point in relation to new managed assets in its discussion of a possible European unit - the Europa.

Now, it must be considered that any shift from the dollar to an artificial currency as an international reserve asset would indeed have represented a huge shift away from the “Bretton Woods system as originally conceived”. Thus, the reasoning could not work: the suggestion of a substitution of dollars with SDRs would not have been a move back to Bretton Woods, but the birth of a totally different system, in which, implicitly, a European monetary bloc could have had a more important role. However, it was important to the UK not to seem too much leaning towards Europe in a European forum. At the same time, though, the strategy included the consideration of a new European monetary unit, perhaps to be used as the underpinning of this new international system instead of the SDR.

Being rather supportive of a “one world” solution which could basically rescue the fixed exchange rates system, British policy-makers on the Whitehall side would have readily supported the Smithsonian realignment even before the political dramatization

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87 “The primary objective is to restore currency stability, halting the process of restriction and counter-restriction in the fields of trade and payments. This requires a realignment of existing parities: so that the major countries can resume maintenance of normal dealing margins around parities. [...] The pound should not appreciate overall, and if possible should depreciate in relation to EEC currencies.” Ibid., 9 September 1971.

88 “The second main objective [was] to move towards a reformed monetary system in which some neutral and internationally managed asset, such as SDR, would form an increasing part of national reserves and would be the numeraire in terms of which parities would be expressed and exchange rates would move. Such an asset might progressively replace key currencies in national reserves, and would be the sole source of new international liquidity.” Ibid., 9 September 1971.


90 TNA, T312/3369, 9 September 1971.


92 TNA T312/3369, 9 September 1971.

of the whole issue triggered by Nixon's policy package. On the other side, however, the Treasury secretly liked the idea of free floating, as witnessed by Operation Baytown. This idea, however, despite not proving as disruptive as some of its opponents had claimed, did not prove particularly valuable either: after an initial appreciation from $2.40 to around $2.80, the British pound kept being exchanged at around the same value. This shift, a cost in terms of competitiveness of British products towards the US, was matched by similar movements in all other currencies of the system, so that the value of sterling remained rather similar.

At the same time, EEC countries had started to talk much more seriously about the "monetary snake", whose implementation still stood firm, with an early 1972 deadline. In such situation, British policy-makers had to decide what to do with regard to the possibility of joining the project; indeed, the Parliament - despite the mentioned difficulties - had just voted in favour of British accession and of the date of 1 January 1973. As a consequence, the UK would have already been allowed to enter the "snake" along with the other countries, in 1972.

A loose consensus is still a consensus

As has been shown, the British policy-making core was composed of the group gathering around the civil servants' views and the governmental side of party politics, and the main difference between the two groups was the view on the desirability of floating exchange rates. If the people and institutions described had started to look positively towards Europe as a consequence of the suspension of gold convertibility, several others had remained firmly opposed to a European monetary system. In particular, these were the Conservative dissidents captured by Powell, the CIA, and the trade unions.

With the exception of these actors, the European monetary bloc solution came to be seen as acceptable to both the mainstream groups: those already committed to a "one-world" solution of fixed exchange rates saw the "snake" as a useful complement to the existing Bretton Woods parities - hence the expression "snake in the tunnel" - while those pushing for (or more or less openly seeking) free floating still saw it as a useful way in order to have monetary stability with the main trading partners, in this case looking forward to something that would later be labelled "snake in the lake".

Meanwhile, the Bank continued to exchange memoranda with the Treasury pushing towards a European monetary bloc, while Heath and his men were increasingly paying attention to scholarly calls for floating rates such as Samuel Brittan's and George Bolton's. The result of this situation was that, faced with the risk of deterioration to the British balance of payments brought about by a worsening of the current account as a consequence of the 10% American tariff, for the time being, the British pound was effectively allowed to float on the market. Floating was less than a best choice to both Heath and Barber, not to mention O'Brien, but it was looked at as the least disruptive measure, despite it still being a leap into the dark. Luckily, however, the total upward change between August and December 1971 was $0.40 - or a 16.6% appreciation - and the much feared volatility was not as large as to disrupt market conditions.

Other proposals were taken into consideration but were never given the necessary momentum to succeed, due to strong interests opposing each of them: a purely free

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95 "Baytown", TNA T312/3215.
98 "This discussion is taking place in the light of the outcome of the House of Commons vote on October 28. We have of course taken note of that vote, though it does not alter our position or remove our serious apprehensions about entry into the EEC." "Britain and the EEC - Comment for NEDC Representatives", NEDC/TUC, TUC Archive, MSS 292D/567/221/1, 3 November 1971.
103 George Bolton to Edward Heath, TNA PREM 15/310, 9 September 1971.
104 Reading to Armstrong, "The Passing of the Partitions", TNA PREM 15/310, 13 September 1971.
floating system, a system completely based on a virtual international currency such as the SDR, or the realignment of the price of gold in terms of dollars as opposed to a realignment of the latter's parity with all other countries. The mainstream opinion among policy-makers shifted therefore towards the second solution, that is, a general realignment of parities allowing a de facto devaluation of the American currency by around the same amount of the import surcharge: this was the core of the agreement that was discussed during the autumn and finally ratified at the Smithsonian Institute in Washington, DC on 18 December.

Interestingly enough, between August and December 1971, both mainstream and dissident views had a common interest in a successful restoration of the Bretton Woods parities. The former wished to couple Bretton Woods, perhaps in a reformed, more flexible form, with the rising European project for continental monetary integration. The latter saw it as the paramount priority in monetary terms, due to the fact that all alternatives would have been unacceptable to them: indeed, a European monetary system would have gone directly against their own interest, while free floating was seen as a less efficient option. Such temporary alignment of views allowed the UK to get through the Smithsonian Agreement of 18 December. From that point onwards, however, two important questions remained on the floor: how long would the amended Bretton Woods survive? And how desirable was the European “monetary snake”? These two themes were to dominate the economic policy debate during the months that followed.


Essentially, the Smithsonian Agreement operated a substitution of the 10% import surcharge with a general average 10% devaluation of the US dollar against all other currencies. It does not take an economist to realize that the effect of the two measures was roughly the same, in that both of them made foreign goods more expensive to the US domestic market, hence helping the balance of payments to crawl towards equilibrium thanks to an upward movement of the current account. If there had been a “privilege” before 15 August, Nixon’s mid-summer measures had the only effect of reinforcing it further, and the same could be said of the period that followed the December realignment.

Nothing changed in Barber’s two policy priorities - that is, European integration and a revision of the monetary system, as expressed in the previously quoted speech of 9 September - during the months leading to the Smithsonian Agreement of 18 December. Even afterwards, the strategic views did not seem to change: in a position paper circulated on 12 January 1972 by the Foreign & Commonwealth Office to British embassies around the world “for unattributable use with reliable contacts”, one could read the government had “a direct interest in the creation and characteristics of any new international reserve asset since we are the managers of an existing reserve currency, and are committed, given certain conditions, to the running down of its reserve role (in the context of membership of the Communities).” A new monetary system, and Europe possibly birthing a monetary union, was indeed the general position of the Heath Government, which can be reconstructed from the documents available, regarding the short term choices that the country was facing during the months between the summer of 1971 and the Smithsonian Agreement.

The changing equilibrium after the Smithsonian

Something rather important was however going to change in the policy-making scene as a consequence of the decisions taken at the Smithsonian Institute: namely, two

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189 “Perhaps the most prominent and certainly the most satisfying aspect of the recent monetary difficulties has been the close co-operation which has developed between the UK and the Six, five of whom are members of the Group of Ten. We have for all practical purposes been treated as a de facto member of the Communities. [...] the Summit of the Six and Four candidate countries due to be held in 1972 seems likely to put progress in European economic and monetary union, EMU high on the agenda.” TNA FCO 59/835, 12 January 1972.
notable shifts in positions that would have a paramount importance for the country's subsequent choices.

The first shift took place inside the Bank of England. Since at least March 1972, officials disillusioned with how the situation had developed seemed to have ruled out the possibility that the "one world" solution represented by the rescue of Bretton Woods and, until then supported by the Bank - could actually represent a credible long run option. The European bloc looked much better in this sense, and the idea started to circulate that Werner's "monetary snake" could replace rather than complement Bretton Woods.

A second shift took place within the TUC. While the British trade unionists' position on monetary issues had initially been determined by the general opposition to any opening towards European integration for the reasons outlined in the previous chapter, the Smithsonian realignment must have created disillusionment with the Bretton Woods system which was being used in the interest of the US. Indeed, as of mid-1972 TUC's Economic Committee was considering the stability of the pound within the EEC framework as the least harmful option for British workers. If not enthusiasm, this was certainly an important step on the way towards monetary integration, as it was from this point onwards that the TUC no longer opposed monetary developments in this sense and, in order to prepare for the inevitable step, started to become involved in trade union associations at the European level. This shift was certainly welcomed by TUC's secretary, Vic Feather, who had until then struggled in order to accommodate his own Europeanism with the evident anti-Europe stance of the trade union movement as a whole.

The *non obstat* to Europe by the trade union movement and the ruling out of the "one world" hopes within the Bank were coupled with a general reinforcement of the existing supporters of EEC entry, thanks to the positive outcome of the parliamentary vote on the issue, that had taken place during the previous autumn. Such reinforcement translated into the monetary realm with a broad support for the idea of the "monetary snake": Labour's "against the Tory terms" campaign no longer had a reason to exist and, after all, had never been specifically geared against Werner's proposal; the Tory research department, in line with the political leadership, continued to support the idea that the country needed something other than the "one world" solution provided by Bretton Woods. The CBI confirmed the general pro-EEC orientation it had steadily been promoting throughout the previous years and showed sympathy for the "monetary snake", despite maintaining that it could be seen as a complement rather than necessarily a substitute of Bretton Woods, hence supporting a "snake in the tunnel" scenario; the City of London broadly supported the latter view as well, looking at the "tunnel" as a solution to the international role of sterling, which could in this way abandon its world responsibilities but at the same time maintain a regional role in the European area.

**Dissidents and pressure groups shifting towards Europe: the power of inflation**

As has been pointed out, the group that detached itself from the mainstream view was mainly composed of three entities: Powell's "social market economy" Conservatives, joined by the Labour dissidents; the CIA; and the TUC. The first group worked almost as a normal opposition group (despite its membership being horizontal on the political spectrum), while the second was not after all exerting a paramount role in the decisions, despite its potential to cause parliamentary trouble. The third institution however - that is, the TUC - was in a very different position, due to the general rise in importance that trade unionism had experienced during the 1960s. The fact that trade unions could have remained firmly opposed to European integration and supportive of

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114 "[...]
115 "[...] to continue for ever EEC entry would place severe strain on the functioning of the EEC Agricultural Policy.
the existing monetary system would have been, to the government, a problem perhaps even larger than that of the dissidents within the Tory party itself.

In the months that followed the Smithsonian Agreement, then, the relaxation of views by the TUC provided a significant simplification to the whole process of integration. Despite Enoch Powell’s, as well as CIA’s, continuing stance against the shift of the UK’s international trade and monetary equilibrium towards Europe, early 1972 saw the process of integration moving steadily forward. The launch of the snake almost coincided with the decision to float the British pound in the world markets, thus undermining the Smithsonian Agreement, a move which would be similarly implemented by most countries between the spring of 1972 and the spring of 1973, at which point the system was to experience its final breakdown.\(^2\) By June 1972, then, the Heath government and its supporters had brought the country into a completely European framework: after joining the snake in April, hence creating a “snake in the tunnel” situation, on 22 June the pound was allowed to float again relative to the US dollar, and abandoned the “snake” too; a rather different situation compared to only one year before, at which stage all currencies were pegged to the US dollar with a 1% band - that is, a 4% margin between each pair of currencies.\(^2\)

All in all, in 1972 no influential actor would question the “monetary snake” any longer: the shift from Bretton Woods towards European monetary integration had been consolidated. The country would have to make further difficult choices and shifts in terms of international monetary relations, but the picture in which the US and the UK were the guarantors of the post-war gold exchange standard would remain confined within the years 1944 to 1971; and at least at the time of finally abandoning the Bretton Woods parity, Europe seemed to be the new framework of reference for British monetary relations.

Before going back to Britain in the conclusions to the present study, the next few chapters are going to describe a very different country which, surprisingly or not, ended up supporting the same monetary choices as British policy-makers.

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CHAPTER 6

ITALIAN POLICY-MAKERS AND THEIR INTERACTION

1. INTRODUCTION

As a general observation, post-war Italy had always been quite enthusiastic about Europe; in the monetary field however, like many other European countries including Britain, the transatlantic link of loyalty to Bretton Woods was strong. For the inclusion of European monetary integration among the highest priorities of Italian institutions, it took the breakdown of the Bretton Woods monetary system. Such connection, relatively neglected by the existing literature,\(^1\) can be found in the reactions of the Italian government and central bank to President Nixon’s announcement of 15 August 1971, which was followed by the subsequent fluctuation of most currencies - among which the Italian lira - after a long period of stable exchange rates.

This shift can be said to have been due to events that destabilized three broad balances upon which Italian monetary policy had been based thus far. The foremost equilibrium was certainly the one between the monetary side of the transatlantic partnership and the process of European integration, which was broken when the former started to show signs of weakness, to then collapse during the years 1971 to 1973. Secondly, a debate emerged on the sources of inflation, as soon as the events refuted the traditional view according to which inflation should be inversely proportional to

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unemployment. The third destabilized area was the very theory of monetary policy, epitomized in particular by the reversal of policy priorities that had taken place inside the central bank, and whose implications have been described in Chapter 2.

Atlanticism and Europeanism

After twenty years of authoritarianism that had culminated in the most dreadful war the country had ever experienced, within a dozen years since getting rid of its dictators and kings, Italy could be said to be somewhat back on track: a relatively prosperous democracy, with a fast growing economy, a stable and convertible national currency, and a seat in the inner circle of the European Communities. This new situation changed the country’s social and economic conditions by orders of magnitude, but it also brought a number of new problems that needed to be addressed: how to secure the fast growth that was necessary in order to rebuild what had been destroyed? How to finance and equalize such growth, throughout a territory in which the average income difference between the richest and the poorest region required the government to put in place domestic development schemes similar to what the Bretton Woods institutions were trying to implement on a world scale? How to pursue modernization, and at the same time develop the country’s foreign policy in the post-war order?

The answers that were given in the post-war years went in two directions, and this double attitude is responsible for the commitments described above, which translated into monetary loyalty to the international gold exchange standard as well as to the cooperation among European countries.

On the one hand, Italy had been left in ruins by the war. There was not enough capital in order to finance reconstruction. At that stage, the country positioned itself on the Western side of the Iron Curtain; this position had been implicitly ratified in 1947 when the Communist Party was forced out of the government, and became the opposition party by definition throughout the following fifty years. But a security concern had also, implicitly, been raised: the republic that had been created with the referendum of 1946 was still taking its first steps, and no one could actually guarantee the country’s political stability against a coup d’état, not to mention enforce the rule of law. These concerns were given a political answer in the context of the so-called “transatlantic bargain”, according to which economic leadership was traded for the security implied by entry into NATO. The economic side of the bargain was addressed through the financial aid programmes offered by the United States since the very early post-war years. Such programmes required financial stability, and such stability would have been guaranteed by the adherence to the Bretton Woods fixed exchange rates system, which became the cornerstone of Europe’s post-war reconstruction.
On the other hand, Italy's largest share of foreign trade took place with Germany and France. This feature created an obvious case for a customs union, starting from the most important commodities - at the time coal and steel - and moving on to all other goods. Moreover, since the country's unification in 1861, Italy had struggled with the problem of the Mezzogiorno, which was still in very poor, pre-industrial conditions compared to the Northern region. As is known, markets fear asymmetrical economic conditions as a potential cause of economic shocks; hence, the establishment of a European common market needed to be backed by actions of redistribution of wealth, which would have represented the opportunity for Italy to share the problems of the Mezzogiorno with the other partners in the European project. This was a further strong driver towards European integration on Italy's side, as was the case of all countries that ended up being net recipients of funds at some stage of the formation of the European Communities.

**Domestic or imported inflation**

A second issue upon which the monetary choice ended up being linked was the debate about the real sources of the inflation that affected Italy since the mid-1960s. The literature on this aspect, as presented in the introductory chapter, is useful here. If Basevi and Onofri were right in saying the inflation came from abroad, the blame could have been put on Bretton Woods. In the explanation suggested by Fratianni and Spinelli, the fixed rates would have been no cause for inflation, although certainly it was undeniable that they were not to solve it: the fixed rate exposed the domestic economy to competition from countries whose inflation rate was lower, and therefore investment yielded more, prices were more affordable, and so forth.

**The quest for sustained growth**

The third and final destabilizing aspect of policy-making was the already described shift of focus in monetary policy objectives. As is the case for most other Western countries, in post-war Italy the responsibility for economic policy-making was shared by the government and central bank. The Bank of Italy itself, in a publication of 1966, under the heading 'monetary policy' affirmed that 'there is no doubt that in Italy the formation of monetary and financial policy is nowadays the government's responsibility.' In practice, such responsibility has always been shared, and as has been pointed out in Chapter 2, Governor Carli believed in the promotion of economic growth rather than in the defence of price stability - that is, exactly opposite to the description that has been made of what was going on at the Bank of England.

**The political framework**

It goes without saying that none of the changes sketched out above was entirely grounded in economic theory. When Giulio Andreotti became Prime Minister for the first time, in February 1972, in his opening speech he mentioned that '[...] we need to get the economic crisis out of a critical situation, perhaps fostered more by psychological and political elements than by technical conditions of invincible hardship [...]'. His views on economics were certainly not naive, and his choice to describe Italy's situation in this way was due to the fact that, indeed, ideology always played a role more important than economics in shaping the country's choices.

How were ideology and economics translated into policy, then, in the Italian society of the 1970s? At the time, the political game was structured around traditional parties, workers gathered and expressed their discontent through trade unions, and the few...
existing media enjoyed an extraordinary power, the sources of alternative information being rather limited. The latter element is somewhat striking, when one finds out that a
ticker like L’Unità was regularly able to present the Soviet Union as a prosperous
country and describe the views of the Soviet press as more balanced as those of the
Western media, just as easily as Corriere della Sera - in the very days of Nixon's
much discussed monetary choices - managed to depict Henry Kissinger as the hero of
the day, when the news of his secret trip to China became public. Eventually, one has
to conclude that it makes sense to structure the analysis of the existing debates and
strategy options through the study of how these were developed within the existing
institutions.

As to the composition of the government, the balance of power of Italian politics
assigned to Democrazia Cristiana (DC) - a party whose name translated into “Christian
Democracy” - the responsibility for the formation of every single cabinet since the
elections of 1948. Given these conditions, obviously the Christian Democrats played the
most important role in all fields of public policy, including foreign and economic policy, while the Communists were constantly excluded from governmental responsibilities as an explicit American condition for the provision of financial aid. The most prominent ministers in the Cabinet were usually members of DC, and very often the public debate around policy choices was actually an internal debate within this party, while the positions expressed from the outside of it were just a complement to it.

The reasons for such a peculiar balance of power must be sought in the very special position of the country at the time it came out of World War II, at which stage the Catholic Church and Europe’s largest Communist party were the two main political
forces that influenced Italian politics. The norm was to have DC in power, either with
single-coloured or coalition cabinets, and PCI as a sort of permanent shadow cabinet.

Among the smaller parties, besides the Republican party (PRI) - which had a share of
around 3-4% but was often well represented in the cabinets - another set of political
views became very influential: the Socialist doctrines promoted by the Socialist Party
(PSI), as well as by the Social-Democratic Party (PSDI). Despite several divisions and
reunifications, these parties represented the softer, left-wing alternative to Communist
ideology, and as such, Socialists started to be part of the cabinets since the early 1960s,
creating the concept of quadrupartito (a coalition of four parties) composed of DC, PRI,
PSI and PSDI, a formula which was to become a political constant throughout the 1960s
and 1970s.

It was, indeed, a change in the Socialist parties’ equilibrium that paved the way for
the story that is narrated here. Indeed, after six years of quadrupartito cabinets led by
Aldo Moro, in December 1968 he was replaced by Mariano Rumor, belonging to the
same DC group. The changeover was required because of the unification of PSI and
PSDI into the Unified Socialist Party (PSU), an experiment that was to last for just a
few months until July 1969. The cabinet, formed by DC, PSU and PRI, was still
formally a centre-left coalition, although it had to be transformed into a single-coloured
DC government after the failure of the PSU experiment in July 1969. But this shift was
just an introduction to a wider, tidal change in the governmental equilibrium, as would
become evident by the end of the year.

As historian Giuseppe Mammarrella observed, a single-coloured government “was
the least fit cabinet in order to deal with the events of the autumn of 1969”. Trade
unionist claims, extended strikes, student protests, and the lack of communication with
the representatives of these classes (many of whom, as has been observed regarding
trade union leaders, belonged to Communist and Socialist parties). Despite the GDP
growth targets set by the Piano Vanoni and its subsequent surrogates, and probably due
to the wrong instruments used in order to pursue such growth - as described in Chapter

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23. The way L'Unità described the reaction of the Soviet press is just an example of this. L'Unità, La
stampa sovietica sulla valutazione del dollaro - Conseguenze delle spese militari e dell'aggressione nel
vietnam, 18 August 1971, p.4.
25. Although Sergio Romano contested the existence of such an imposition. Sergio Romano, Guida alla
26. Alfonso Prandi, “Le raccomandazioni dei vescovi”, in Mattei Dogan and Orazio Maria Petracca (eds.),
27. F. Roy Willis, Italy Chooses Europe, Oxford: Oxford University Press, 1971, p. 288. Palmiro Togliatti,
Il partito comunista italiano, Milan, 1953, pp. 103-107.
28. In the late 1960s, PSDI adopted the denomination of PSU, Unitary Socialist Party for a brief period.
economic and monetary policy during 1970. The situation would change, partially, with the formation of a new cabinet; at any rate, this observation should have made it clear that virtually none of Italy’s post-war policy choices could be understood without taking a deeper look at the Christian Democratic party and its internal debates.

2. THE CHRISTIAN DEMOCRATS AND A MULTI-DEPENDENT FOREIGN ECONOMIC POLICY

In order to sketch out the general position of DC towards the international monetary regime as of the late 1960s, it is useful to recall that many equilibria had changed since the beginning of that decade and the cabinets, typically DC single-coloured, switched to being centre-left coalition cabinets, with the inclusion of members of other leftist parties. This shift reflected many changes in the Italian society, and as regards the international political situation, it can be argued that it also reflected the weaker influence of the United States on Europe, as well as the distance from the beginning of the Cold War. On the one hand, the US was no longer financing Italy through aid plans, and at the same time it was running deficits which - according to many - made it unfit for the leadership of the international monetary system. On the other hand, the Cold War that had begun after World War II was slowly reducing its influence on European countries. What seemed a terrible nightmare in the 1940s - that is to say, Communists or Socialists as members of the cabinet - was no longer a problem in the wealthier conditions of the beginning of the 1960s, even when the leader of a governmental party like PSI could promote a foreign policy which “without discussing the alliances already made by the country [...] should be aligned with the most advanced currents of European and world public opinion which, inside or outside the blocs, stress

Party politics, even on the governmental side, was somewhat following rather than leading these debates. Prime Minister Rumor was exceptionally weak in his single-coloured cabinet, whose life cycle was indeed short. One could claim that, in a way, Carli and his people at the Bank had been the real authorities of DC in terms of

28 Ibid., p. 288.
the importance of détente and on the organization of peace."\(^\text{35}\) On the contrary, industrial reconstruction had brought to surface many social tensions that ended up in a reinforcement of the parties most typically related to the workers' conditions, which is to say, the left wing.\(^\text{36}\)

### 2.1. The case for European integration

At the beginning - at the times of the European Coal and Steel Community (ECSC) and then the Rome Treaty - integration with the largest trading partners was seen as a step towards economic wealth and progress much needed in order to rebuild the economy;\(^\text{37}\) and it also had a concrete function in coordinating and making the best of the financial aid programs offered by the United States. As has been pointed out, arguably the very first communities of Europe had been the European Payments Union (EPU) and the Organization for European Economic Cooperation (OEEC).

In particular, DC being the largest party and representing the "core" outside of which all other opinions were complementary, it will be interesting to have a closer look at what the Christian Democrats thought during these years.

As mentioned, the Italian attitude towards European integration had been determined by trade patterns, while that towards Breton Woods had mainly been due to the need of American financial aid during the post-war reconstruction. The position of all the establishment, led by DC, had thus been very clear at that stage.\(^\text{38}\)

By the mid-1960s, however, these motivations had to be left aside: the economic boom had taken place, and the dollar shortage had been replaced by a "glut". Nonetheless, DC did not change its general attitude towards European integration; rather, it found new motivations. Europeanism was widespread in the party: commenting on Pierre Werner’s proposal in 1970, a DC member of the European Parliament pointed out first of all that the "growing interdependence" of European economies was such that "the control of economic policy has become harder insofar as the loss of control by the national level has not been compensated by a stronger initiative at the Community level." In the same passage one also finds the second order of problems, that is to say, the fact that the European common market was not a static machine, and while history brought Europe towards new conditions, "unification of monetary policy" would be necessary in order not to bring the European process into a "phase of involvulation".\(^\text{39}\)

But there was also, of course, another type of interdependence, that is to say, the transatlantic economic relation: while "the lack of a common monetary policy has weakened the position of the member states in international economic relations, [...] we will say that in general we all agree on the positive effects of the stabilization of exchange rates, due to the reflection on the stability of the green dollar [...]."\(^\text{40}\) The link between European cooperation and the dollar must come as no surprise, given what has been said regarding the double loyalty of the Italian Christian Democrats to the ideals of Europe as well as to the transatlantic link.

**DC's participation in the “Comité pour les Etats Unis d’Europe”**

In the new conditions, the almost mechanical positions of the main Italian governing parties were allowed a much wider flexibility. The more conservative voices within DC - Giulio Andreotti to cite one prominent name - were still leaning towards the transatlantic link,\(^\text{41}\) while more leftist voices were advocating, by the mid-1960s, the United States of Europe as a way to affirm autonomy from the US, that is, exactly the opposite as the reasons that had pushed the United States to support such ideas in the previous decade.\(^\text{42}\)

As a matter of fact, in order to explore the position of notable members of Italian governing parties as of the mid-1960s, especially belonging to the more progressive, left


\(^{39}\) Istituto Storico, Fondo DC, Segreteria Politica, Atti dei Segretari, Box 221, 1970.

\(^{40}\) Ibid.


wing of the party, it is worth considering their being part of the “Comité pour les Etats-Unis d’Europe” which had been formed under the aegis of Jean Monnet and Willy Brandt. The main idea was to lift Europe to the same level as the United States while discussing issues of international policy.

The interesting point is that the views of the left areas of DC and the Socialists converged in such Europeanist ideas, which by that time implied an economic confrontation with the United States. Among the names of the members of the “Comité”, one may find the DC and future Prime Minister Mariano Rumor side by side with Mario Tanassi, leader of PSDI, Ugo La Malfa of PRI, and even the Liberal Giovanni Malagodi, as well as trade union leaders Enzo Dalla Chiesa (UIL) and Bruno Storti (CISL).

Curiously, the traditional Socialist Party, PSI, was not represented in the “Comité”. Perhaps the reason was the clear position expressed by Jean Monnet’s creation regarding the role of NATO in the would-be United States of Europe, to which the Italian Socialists were still allergic: “The security of the free world can only be assured within the framework of the Atlantic Alliance.”

Hence, the views of the “Comité” presented a clear view of a self-sufficient Europe able to compete with the United States but, at the same time, the reinforcement of the NATO framework in terms of security, in line with the bipolar confrontation with the Soviet Union. Within the West there could be competitors but not enemies: one could not have been anti-American in order to promote unity in Europe. This was the primary reason why no Communist party adhered to Monnet’s initiative.

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Different DC ideas on Europe’s future

There is also one further element that one must not forget to consider with attention: after Jean Monnet’s initiative of the “Comité”, the late 1960s were years in which the idea of a political union of Europe was again resurrected, after the failed attempt to establish a European Political Community in the mid-1950s; and the idea of a European political union was accompanied, in the mind of politicians, to a widening of the political relations with other parties of the same colour all over Europe. As a matter of fact, one of the largest issues at stake in reaching political union was that, at that stage, the European Parliament was assumed to require a direct electoral system (which, instead, ended up being introduced only in 1979). International cooperation among parties was therefore seen as a priority; and in the case of the Christian Democrats all over Europe, it was also seen as an opportunity: many countries of the Six had large parties of this colour, and it is undeniable that the - already existing - European union of Christian Democrats would have gained a very heavy influence over European policies. One needs to adopt this perspective, and remember that Pierre Werner was a Christian Democrat himself, in order to understand why DC MEPs pointed out that his Plan, “By summung up the positive sides of the experience made, it suggests an intensification and adjustment of the informal process that has already been implemented through the periodic consultations among financial ministers and central bank Governors, and an institutionalization of this process.” The “adjustment of the informal process” through its “institutionalization” inserted itself in a much broader strand of Europeanist thought, spanning from trade relations to home affairs, and would have in fact reinforced the EEC’s influence over national policies, therefore giving Europe’s largest political movements an even heavier weight, something that the Christian Democrats were well aware of. Moreover, by stressing that Werner’s proposal “[did] not say anything new and different from what has already been said and accepted during these years in the monetary sector”, the MEPs implied some faith in the
However pointless in its subject, this discussion shows the attitude of DC’s foreign office, and explains the American half of the party’s position towards monetary issues. Of course, European integration - including its monetary side - was an appealing project in the light of an international coalition of Christian democrat forces, and after all Pierre Werner himself was a DC; however, there was also a transatlantic relationship to be taken care of.

2.2. Europe or America? The foreign policy implications of DC’s internal fights

Bemassola’s line (which was also secretary Forlani’s) was then the dominant one. However, as has been pointed out, not all voices within DC shared the same views in terms of international policy choices. Despite the claims - more rhetorical than real - that the party’s political line should have been united, what happened in reality was the formation of different internal groups, or as they were called, correnti (“streams”). These groups were more about the search for power than about conceiving different ideas in terms of policy-making, although of course, their composition often reflected the relationships that existed between DC politicians and other political forces, or the electorate. This explains why sometimes it is hard to list the people belonging to the different groups: while Arnaldo Forlani and Emilio Colombo were basically friends of ours with the French Gaullists, represent a serious threat to the European and democratic effort to which our party is committed [...], with a clear and strong line against the Gaullist vision of Europe.51

To his credit, what Zamberletti had written on La Nation on 7 January was simply an appreciation of De Gaulle’s claims that Europe should take care of its own defence, which was something the Americans themselves had been repeating for a long time while talking of NATO’s burden sharing. However, the way he put it in the conclusions to his article was that “We do not hide that many of General De Gaulle’s initiatives are still not acceptable to us; but we have to recognize that, in the light of the orientation of our own future work towards European unity, we attribute a great relevance to General De Gaulle’s intuition that Europe, in order to be itself, must detach itself from American tutorship [...].”52

However, as has been pointed out, not all voices within DC shared the same views in terms of international policy choices. Despite the claims - more rhetorical than real - that the party’s political line should have been united, what happened in reality was the formation of different internal groups, or as they were called, correnti (“streams”). These groups were more about the search for power than about conceiving different ideas in terms of policy-making, although of course, their composition often reflected the relationships that existed between DC politicians and other political forces, or the electorate. This explains why sometimes it is hard to list the people belonging to the different groups: while Arnaldo Forlani and Emilio Colombo were basically dorotei in terms of political views, at some point in their careers, as will be pointed out, the former could be described as finfaniano and the latter as andreottiano.54

At each point in time, the leading corrente was the one from which the secretary came; in the case of Forlani’s leadership, this corrente was that of the dorotei.55 The second largest corrente were the morotei, who took their name from the secession organized by Aldo Moro, a former doroteo, in 1968.56 The other two leading correnti

50 Sergio Romano, Le Italie parallele, Milano: Longanesi, 1996.
52 La Nation, 7 January 1971.
54 Giuseppe Chiaramonte, La Democrazia cristiana, Roma: Editori Riuniti, 1980.
55 The dorotei took their name from the “Convento di Santa Dorotea”, where on 14 March 1959 a group of DC people organized a revolt aimed at putting secretary-general, Prime Minister and Foreign Minister Amintore Fanfani in minority within the party. Agostino Giovagnoli, Il partito italiano: La Democrazia Cristiana dal 1942 al 1994, Bari: Laterza, 1996.
were *primavera*, led by Giulio Andreotti, and the *fanfaniani*, taking their name from the leader Amintore Fanfani.57

The line of the *dorotei* Forlani and Bernassola could be described as generally pro-American, but of that type of Americanism which supported the idea of an independent and united Europe.58 The *dorotei* were also referred to as the right wing of DC, and their economic policy views followed suit: a moderate supply-side creed was promoted in spite of Keynesianism, with a special accent on the stimulation of production as opposed to consumption in order to foster growth. Monetary discipline and a straightforward support of the fixed exchange rates system as part of the post-war order followed suit. Given that - during the years of the cabinet led by Emilio Colombo, who replaced Rumor in 1970 - this group was the common political affiliation of the party’s secretary, of the director of the party’s foreign office, of the Prime Minister, of the minister of finance, and of the foreign minister, one might argue that it was all one needs to know in order to sketch out an overall Italian approach to any policy issue. However, this is not the case. The Italian political system has never been adversarial - the proportional system was the rule until the elections of 1994, and governments have constantly been scrutinized through parliamentary vote - and in order to keep their majorities, the cabinets needed the support of *dorotei, morotei, primavera* as well as *fanfaniani*.

The main representative of the *morotei* was Aldo Moro, from whom the group took its name. The main feature of this group was to be closer to the parties to the left of DC, namely the Socialists;59 indeed, the date of birth of the *morotei* is not by chance in 1968, after some years of centre-left coalition governments: at that stage, the “left wing” of DC - the way *morotei* were labelled - was extremely powerful, while the more moderate groups wanted to find agreements with moderate parties and loosen ties with the Socialists, a policy line Aldo Moro would not endorse.60 In terms of economic policy, the *morotei* were oriented to planning - which indeed Moro implemented throughout the 1960s - with a somewhat Keynesian approach according to which growth could have been pursued through the demand side, i.e. by raising the disposable income and, in turn, consumption. Along the same lines was another smaller group, which had a longer history reflecting the relevance of their own leader before the *dorotei* putsch: the *fanfaniani*. The political dominance of *morotei* and *fanfaniani* was shadowed by the crisis of the Rumor cabinet in 1970, the last left-wing cabinet before the several years of right-wing dominance started by the cabinets of Colombo and Andreotti, respectively in 1970 and 1972 (although the former was rather a transitional government: despite being dominated by *dorotei*, the formula was still a centre-left *quadripartito*).

As a consequence of the domestic political position of these two groups, some foreign policy views followed. The former was a relative detachment from the influence of the United States, which was expressed by welcoming Willy Brandt’s Ostpolitik,41 as well as by putting a special accent on the process of European integration through support of the - typically Socialist - idea of a political union among the countries of Europe.62 It is not by chance that one could find the name of Mariano Rumor - a prominent *moro(t)ei* - among the members of the “Comité d’Action pour les Etats Unis d’Europe”, as has been pointed out.63

The *dorotei* saw themselves as the guarantors of the relationship with the United States, which they held as the main ally in the post-war order.64 they fully endorsed NATO’s mandate and saw Brandt’s Ostpolitik as a threat rather than an opportunity.65 In the case of European integration, as has been seen, they saw it as an anomaly that the “left wing” of the party could push themselves as far as to sympathize with De Gaulle’s views on Europe; indeed, the French President’s claims of the US enjoying an “exorbitant privilege” were exactly the opposite of *dorotei’s* own ideas regarding the fact that the special relation with the Americans turned out to be positive to the country’s development. In the middle of these general “right wing” views on

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international politics, a figure emerged, not for his physical height of six feet three, but for his own peculiar ideas: Giulio Andreotti and his corrente, referred to as primavera.

Andreotti was a very influential figure in post-war Italy as well as a very prolific writer, and this feature helps in the reconstruction of his thought throughout these years. He was not yet Prime Minister at the time this research is exploring; but it was only a matter of chance that he was not in place of Colombo. Actually, dorotei and primavera were very close to each other, and often labelled together as the moderates, or right wing, of DC. Indeed, Andreotti described the formation of the government in the summer of 1970, revealing how he had actually been designated to try to form a government just some days before Colombo. 66

As to Europe and the United States, Andreotti’s ideas were in line with the immediate quasi-mechanical choices of the post-war order. Indeed, his political commitment had basically begun with the Second World War, and his peacetime political career had begun with the creation of the Italian Republic in 1946. Describing the traditional post-war foreign policy choices of Italy, he addressed “those who critically reveal the fragile shortness of our cabinets” by replying that “on the main lines, especially regarding foreign policy, the Italian Republic has shown an exemplary continuity. For instance, we can proudly affirm that we are not second to any other country in terms of Atlantic loyalty and Europeanist passion.” 67 Atlanticism and Europeanism then did not clash against each other, as in the classical dorotei vision in which too much Europe was dangerously synonymous with either Gaulism or Socialism. In 1971-1972, the Bank of Italy’s Governor himself would shift his own views on Europe closer to Andreotti’s, in a sort of connubio between central bank and government that was not necessarily to be taken for granted during years in which the economy, as well as economic theories, were changing much quicker than in the past.

66 As he joked, this was not due to the fact that President Saragat was inviting the candidates in alphabetical order. Giulio Andreotti, Governare con la crisi, Milano, 1991, p. 158.

3. UNEASY ALLIES: UGO LA MALFA AS THE “CASSANDRA” OF ECONOMIC POLICY

One of the main personalities outside DC was Ugo La Malfa, the leader of the Republican Party, who was especially concerned with the changes of attitude towards capital flows and inflation, especially analyzing the consequences of these themes on the domestic economy. During the month of July 1970, the Republican Party had focussed on the problems of Italy’s economy in the light of the formation of the new Colombo government and of the programmatic ideas that it should use as its platform. The main claim expressed by La Malfa was the anti-Keynesian assumption that the previous administrations had taken too many financial commitments in the public sector, as “taking into account the current expenditure only, the public sector has drawn 5,500 billion [liras] from the financial market [...]. The amount of 5,500 billion, should it be used in total, [...] seems simply huge, and would make government and monetary authorities confront with choices that are almost without solution.” 68 The suggestion brought forward in order to address this problem was that the new government should have started “a strong and immediate revision of the financial commitments of the public sector”. 69

After the publication of these theses, La Malfa had been offered the Ministry of the Treasury in the Colombo cabinet, during the talks of July 1970. In a private letter sent to him on 3 August, Indro Montanelli, inviting him to accept the position, sketched out the problems related to it:

Dear Ugo, I do not mean to give you advice: you are a political animal, much more than me or anybody else. [...] Now that it looks like this cabinet will be formed, however [...], many are wondering what you will do, i.e. whether you will go to the Treasury. [...] I know very well that, if you stay out, it is because you do not trust this government, and think it would not give you the means you need in order to try a saving action. [...] I suggest you should be

68 Archivio Centrale dello Stato, Carte La Malfa, Envelopes 89-99, 26 July 1970.
69 Ibid.
very clear on this point [...] so as to rule out any doubt on your alleged allergy to responsibilities.  

Eventually, La Malfa refused, and the Ministry of the Treasury went to the DC Mario Ferrari-Agrardi.71 This event defined the position of PRI regarding the economic policies of the newly formed government. This is particularly useful when it comes to evaluate this party’s positions in terms of international economic policy, and more specifically, the position regarding the monetary choices to be confronted within one year after the formation of the Colombo cabinet.

On his side, La Malfa was not anti-American at all. This was not to be taken for granted: given the already mentioned positions on domestic economic policy, one easy claim - very widespread among the Communists - was that one aspect of the economic troubles Italy was dealing with was the imperial tax that was being imposed by the American deficit. This idea was also supported by De Gaulle and, as has been seen, by some DC MPs who had publicly supported the French President’s views on the role of Europe. La Malfa, however, clearly distinguished the problem: during his speech at the party’s Congress of 1968, he stated that “[...] only a pseudo-scientific analysis may affirm that the economic power of the United States has been developed on the basis of a policy of imperialism and colonial exploitation, rather than on the basis of the use of large domestic resources as well as the availability of a huge territory in which that society operated, conditions which after all characterize the Soviet Union itself.”72 In so doing, of course, he put all the blame on the Italian government, as being unable to limit public expenditure as well as financial exposure.

4. THE OPPOSITION FROM BOTH FLANKS

With the Christian Democrats at the centre of the political spectrum, governments occupied a space that ranged from the Liberal Party (PLI) on the right to the Socialist Party (PSI) at the far left, with the pivotal party involved in “a continuous and successful adaptation of a complex organisational structure to environmental changes and political challenges”.73 PLI and PSI, together with Ugo La Malfa’s Republican Party (PRI) and the more recently formed Social Democrats (PSDI/PSU), were the only ones that experienced both being at the government and at the opposition during the post-war order up to the period dealt with here. Indeed, DC was always in office, while at each end of the spectrum there was one party that represented the permanent opposition: the Movimento Sociale (MSI) had some elements of continuity with the Fascist Party of the interwar period, and the Communist Party (PCI) had been excluded from the government since the 1947 American veto. The Christian Democrats “succeeded in pushing to the margins of the political spectrum the MSI (Fascism) and the PCI (Communism): the so-called opposed extremisms”.74

4.1. The extreme right

Since the 1948 constitution prohibited fascism in every form, MSI stressed its continuity with fascist ideology through policy ideas not directly referred to it, but clearly oriented at supporting the fundamentals of Mussolini’s interwar dictatorship. In 1970 party officials were still expressing views such as that “one cannot be a fascist and at the same time accept the modern philosophy of democracy, with its negative values of freedom, egalitarianism, fraternity, not intended in terms of moral - in which case they are sacrosanct - but in terms of political practice [...]”.75 In terms of economic policy, in particular, the alliance with the United States was looked at as an unnecessary form of subordination to a foreign power during the Kennedy and Johnson years, especially due to the perception of a “moral demobilization of the West and of its anti-Communist defences that took place during the years of the Kennedian euphoria”,76 while the traditional economic tenet was the defence of national pride through economic self-sufficiency.77 In this sense, Europe too was seen as a project harmful to the

70 Letter from Indro Montanelli to Ugo La Malfa, 3 August 1970. Archivio Centrale dello Stato, Carte La Malfa, Envelopes 89-99.
72 Ugo La Malfa, L’altra Italia, Milano, 1975, p.133.
76 Amato Michelin, Il Secolo d’ Italia, 29 September 1968.
maximization of national sovereignty unless, ostensibly, it became "an independent and powerful Atlantic Europe", a position which basically placed MSI in the mercantilist tradition according to which the maximization of the terms of trade was the only acceptable principle of foreign economic policy. Its position regarding Europe was a simple projection of nationalism rather than an acceptance of continental integration: in the 1971 tour for the round of local elections that were to take place in June, one of secretary Almirante’s main points was the promotion of a "creative nationalism" against the "internationalism of imperialists". Hence, MSI’s position remained rather irrelevant to the goal of the present research, if not in pointing out that the extreme right-wing party was basically against anything different from a mercantilist view that would probably fit better into the late nineteenth century than into the late twentieth. At any rate, such consideration does not have a real impact on the results: both numerically and ideologically, MSI had been cast out from Italy’s post-war era, and would not come out of its corner until well after the 1970s.

4.2. The Communist party

The party representing the extreme opposite of the spectrum had a significantly different history and role in the post-war order. Indeed, PCI enjoyed a much larger electoral base, and Communist ideology shared a central role with the Catholic forces in defining the new Italian state as it emerged from the Second World War. The expulsion of PCI from government in 1947, a tribute to Marshall aid, earned the party a permanent place in opposition. It was not, however, a silent or unthreatening opposition: several times during the 1940s and the 1950s the Christian Democrats experienced the very realistic fear of their electoral results being overtaken by the Communists, and even the centrosinistra experience launched by Aldo Moro in 1963 may be seen as a sort of domestic containment put in place in order to avoid an excessive shift of public opinion to the left, as a consequence of the economic policy troubles Italy went through during that decade, as well as of the rise of trade unionism, many of whose leaders were also PCI members. In general, then, the political weight of the Communists was far from negligible.

**Communist ideology and Breton Woods**

In the area of economic policy, PCI inherited its own guideline beliefs from Communist ideology; at least until the mid-1970s, the official vulgata of the party leaders stressed the same revolutionary ideals that had once upon a time led to the decision that the party was unfit for government. The working class was at the core of the economic discourse; redistribution of wealth remained the fundamental principle; and the final goal was a society based not on private property but on a completely state-controlled economy. In this picture, the United States was seen as a subject not compatible with the Communist idea, and as such it was opposed in any of its projections. The Breton Woods monetary system was one of these: the trade agreements of the Kennedy Round were another; even the promotion of the idea of Europe was looked at as a negative propagation of American views in Europe: indeed, the possible future united Europe would belong to the capitalist world as opposed to being a revolutionary alternative to it. In a parliamentary session of June 1971, Senator Fabbrini summarized the situation by saying that "the European Community will not be

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80 Maria Serena Pietrini, _Le elezioni politiche in Italia del 1849 ad oggi_, Bari: Laterza, 1996.
81 Later on, Moro would talk about the changes of Italian society in the 1960s as a consequence of the "incredible flow of history". Giuseppe Chiariante, _La Democrazia cristiana_, Roma: Editori Riuniti, 1980, p. 107.
84 [..] the point is not to start from scratch but from the goals already achieved in this side of the world through the efforts of all the components, and of both wings - the Communist and the Socialist or Social-democratic ones - of the workers’ movement." Giorgio Napolitano, "Il PCI secondo il PCI", in Silvano Helligni (ed.), _La giroffia e il lascito: il PCI dagli anni ’70 al nuovo decennio_, Milano: FrancoAngeli, 1983, p. 25.
85 Centro Studi di Politica Economica del CC e del PCI, _CESPE, Aspetti dell’attuale situazione economica internazionale_, Bollettino no. 29, April 1969, pp. 21-25.
able to achieve an effective autonomy due to the American military policy, which tends to load Europe with the economic consequences of the Vietnam War.\textsuperscript{2} In a nutshell, this explains the overarching reason why the Italian Communist Party remained opposed to both the Bretton Woods monetary system and to European monetary integration, at least until the death of the former and the birth of the latter.

\textit{The economic case against Bretton Woods and Europe}

More economic arguments were brought forward as well. PCI’s study centre for economic policy warned “the dollars circulating outside the USA have often been used in order to implement the American imperialist policy” and that such intent has been carried out through upward adjustments to the interest rate which has generated a competition “towards raising interest rates worldwide, whose immediate consequence has been the intensification of capital movements from one country to another, with very grave effects for the equilibrium of the entire system.” Moreover, upward pressures on interest rates were also generating inflation “as a direct consequence of the growth in the cost of money” and the combination of these elements might determine “the comeback of protectionist practices that seem to be in sharp contrast with the address of the liberalization policy that international trade has experienced since the 1950s.”\textsuperscript{3}

Only one year later, the central section of PCI’s “party schools” published a booklet in which Renzo Stefanelli described the introduction of the Special Drawing Rights scheme as the “creation of the paper-gold, or drawing rights, that is a paper reserve currency which [...] is going to fuel one quarter of the USA’s reserves, thus helping it further to cover its own deficit. [...] the creation of paper-gold in this form is the logical consequence of the acceptance of the American lead on the imperialist area and of the role of the dollar.”\textsuperscript{4}

\textsuperscript{2} Senato della Repubblica. Commissione Affari Esteri, 3\textsuperscript{a}, Sedute delle Commissioni, 304, 24 June 1971, p. 36. As a confirmation of the importance of this debate, a copy of it may also be found in Pietro Nenni’s personal papers: Archivio Centrale dello Stato, Carte Nenni, b. 129, fasc. 2495. See also Sergio Fabbrini, “Le strategie istituzionali del PCI”, Il Mulino, no.5, September-October 1990, pp. 733-777.

\textsuperscript{3} Bollettino CESPE, Centro Studi di Politica Economica del CC e del PCI, no.29, April 1969, pp. 21-25.


In addition, it is easy to read through PCI secretary Luigi Longo’s words regarding Europe in 1966: “At the time of the creation of the common Market we expressed severe judgments against its principles and institutions as they had been created as an expression of interest and power of the large monopolistic groups [...] Experience has shown that these opinions were grounded.”\textsuperscript{5} These words help understand what the party line was towards Europe in 1969, when the secretary, at the party congress, lamented that “Economic policy in these years has guaranteed freedom of action to the monopolistic concentrations in the important intervention choices, has given incentives to the profit of big capitals, has left revenue untouched, has compressed salaries [...]. The industrial tendency to look mainly at foreign markets has been favoured, while competitiveness was essentially increased by intensifying exploitation.”\textsuperscript{6}

The Italian Communists’ position regarding international integration, then, suggested that heavier attention would have to be paid to the domestic economy: on the one hand a detachment from the costs of American imperialism that were loaded on the rest of the world through the monetary system; on the other hand a criticism of Europe as an expression of an imperialism of the same kind, but enacted by monopolistic groups. And in the background, two further economic observations: that inflation came through the monetary system via the American seigniorage as well as the interest rate mechanism, and that export-led growth would not be the best solution for Italian economic troubles. All these elements, inevitably, determined that PCI had a nationalist approach to the economy, and this curiously ended up being the common trait, coming from both sides of the opposition, against Bretton Woods and Europe.

\textbf{5. INSIDE AND OUTSIDE POLITICS: THE BANK OF ITALY}

Guido Carli served as Governor of the Bank of Italy from 1960 to 1975. Such a long mandate, a distinctive feature of the Italian central bank’s tradition, gave him, as well as his predecessors and successors, a huge leverage on the institution itself as well as on the entire political system, as all other positions - especially within the government -


\textsuperscript{6} Luigi Longo, Testi per il XII Congresso del PCI, February 1969.
had a much quicker turnover. Despite Giulio Andreotti’s defence of the Italian political system, based on the acknowledgement that governmental turnover was high but the actual people were always the same, certainly the fact that the Governor did not have to respond to the electorate gave him a much greater ability to influence the course of economic policy than all of the other political counterparts he had to face. In this sense, Spinelli and Fratianni’s definition of Carli’s governorship seems more appropriate: a long reign during which the Bank took the shape its master wished to give to it, including the aim to make it a court where the intelligence of the country gathered, since the Governor understood “the equation knowledge = power.”

As has been pointed out earlier, Carli was a doroteo, and as such was very close to the governmental views of the post-Moro era. Reporting on a meeting of July 1972, Andreotti curiously mentioned two foreign supporters of the Governor, one being French President Pompidou, who “very much appreciated Carli’s ideas, and he just recommended not to create problems to Nixon before his re-election”, and the other being Soviet Prime Minister Kossighin, who made his ambassador to Rome tell Andreotti that “if we had a Carli, we would have solved all of our economic troubles”, to which the Senator observed that “We had Carli, indeed, but our political environment was more committed to internal political battles than to economic issues.”

5.1. Governor Carli and the causes of inflation

Governor Carli’s own ideas on the international monetary regime up to 1971 may be easily tracked from the Bank’s annual report on 1970, which as usual, was published five months after the end of the year following the one it referred to. The Governor thought that “The inflationary pressures, whose farthest origins are to be found in the United States after the end of the period of stability enjoyed during the first half of the 1960s [...] have received their primary input during [1970] because of the satisfaction of very large salary demands concentrated in a short time [...] Given the generalized inflationary climate, such rise in costs, instead of translating into a worsening of current accounts, translated into a rise in prices: where the slow-down of demand has been stronger, this also ended up affecting profits, which contributed to start a downward spiral.”

Hence, Carli saw the causes of inflation in higher Europe-wide salary demands and a slow-down of productivity growth, both of which contributed to raise production costs, which in turn gave rise to an unfortunate economic conjuncture of higher costs and generalized inflation producing a downward spiral leading to more and more inflation. This explanation, however, failed to clarify one point about the nature of inflation: indeed, Carli referred to two different types of inflation. The former was the one which, coupled with higher costs, created the latter downward spiral. The birth of the latter type of inflation is explained by the passage quoted, while the former was taken for granted. Where did it come from? Carli himself offered a hint by claiming that “the general picture of international monetary relations has been strongly perturbed by massive short term capital movements from the United States towards Europe through the euro-dollar market. Such movements have been mainly the consequence of the temporal mismatch in the tone of monetary policies on the two sides of the Atlantic: the need to stimulate the economy in the United States [...] induced the Federal Reserve to pursue a more and more expansionary monetary policy. Due to the use of certain means of intervention, this generated a massive reimbursement of short term loans contracted by American banks in their London branches, and the transmission to the euro-market, with amplified effects, of the fall in short term rates that took place in the United States.”

The Governor then went on to explain that, due to the lower euro-dollar rates, European operators preferred to finance their businesses in that market, which created a flow of funds from the euro-dollar market to the central banks’ reserves, for a total worldwide rise of 14 billion dollars, 12 of which ended up in European central banks. But this is the very well known part of the story. The interesting bit stands in the quote: basically, what Carli affirmed is that the former type of inflation, which he earlier had referred to, had been caused by the export of American inflation. The mechanism had been the following: the American economy needed to be fostered through an

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99 Giulio Andreotti, Governoare con la crisi, Milano, 1991, p. 188.
100 Banca d’Italia, Relazione Annuale per il 1970, pp. 9-10.
101 Ibid., p. 11.
expansionary monetary policy, which determined lower interest rates, and the inflationary effects of such policy were transmitted to Europe through the euro-dollar market. European countries, however, needed all but an expansionary monetary policy, as most of them were already coping with overheated economies and inflationary pressures of a more domestic kind.

What Carli failed to mention, though, is that the United States was able to freely pursue a domestic monetary policy of this type only because of its being the centre of the monetary system. Any other country faced with a certain desired monetary policy could have put it in place only if such policy had not clashed with maintaining the fixed parity of its currency, that is to say, the Bretton Woods rules. The United States, on the contrary, could enjoy the fact that a dollar inflation would be transmitted worldwide, through the euro-dollar market as well as through the loss in value of the part of official reserves held abroad in US dollars instead of gold. The only concession Carli made to the fact that this was an abuse on the United States' side was that "Without doubt, in the second half of the last decade the worsening of the current account of the United States, in particular the contraction of the trade balance surplus, has been the main cause of the formation of a large external surplus. [...] The continuation of such a situation of imbalance is evidently unsustainable, as it throws liquidity into the international financial market in amounts or times unwanted by the rest of the world [...]"

However, this acknowledgement was immediately followed by a claim of collective responsibility, allegedly to be found in the fact that "most countries do not appear to be willing to revalue their own currencies or accept devaluation by the others, in order not to put the competitiveness of their own industries at risk", as if this unwillingness to break the IMF parity rules could even be considered morally wrong. More than that, such a position was backed by a proposed rationale based on pure economic theory: "[...] as the United States' balance of payments deficit is nothing but the counterbalance of the surplus enjoyed by the other countries, the impossibility to find appropriate solutions to this problem is evidently a consequence of the conflict of interest between the need of defending one's own market quotas and that of avoiding the consequences of the American deficit."

5.2. Interaction with other actors on a common European policy

Eventually, then, Carli concluded that "The reaction against the so-called 'benign neglect' [...] is the evidence [...] of the inability of European countries to formulate a coherent common policy towards the dollar." As is clear from the context, such a claim in favour of a European common policy was not oriented towards the birth of an independent monetary system alternative to Bretton Woods; rather, the policies referred to stood in the realm of trade and fiscal harmonization. Indeed, on European integration, the Governor took the view of those who believed that economic cooperation had to come before monetary cooperation, as suggested by Mundell's theory on currency areas: "In the short term, the goal of the economic and monetary union must not lead to a climate favourable to fixing reciprocal parities within the community before the process of unification of economic policies has made sensible progress."

Incidentally, this view was also supported by Confindustria, whose official voice, L'Organizzazione Industriale, on 28 May 1971 commented on the Deutschemark's fluctuation - and the subsequent delay imposed to the process of European monetary integration whose next step should have been a restriction of the fluctuation bands to 0.60 percent the following month - by affirming that the temporary stop "might be beneficial as it will show everyone that it is impossible to reach monetary unification as long as the economies of the different countries have diverging trends and, consequently, diverging will be the economic policies pursued by their governments."

Clearly, depending on the prevailing view, different policy options should have been recommended, and in fact, as has been seen, different positions were defended: the DC and Socialist part of the government moving forward towards a type of European
cooperation that would not replace Bretton Woods; the Republicans of La Malfa accusing trade unions for a domestic driven inflation; the Bank admitting the existence of multiple causes and implicitly defending Bretton Woods by not attributing to it the ultimate responsibility for the worldwide inflation trend.

6. THE GOVERNMENTAL LINE: A HOME-MADE VERSION OF “BENIGN NEGLECT”?  

After several years of marotei domination culminating with the cabinets led by Mariano Rumor, the Prime Minister nominated in August 1970, Emilio Colombo, was not a leader of any of the correnti. At the same time, though, he definitely belonged to the right wing, which was also the orientation of Treasury Minister Mario Ferrari-Aggradi. As well as the Treasury, in 1970 there were two other economic ministries, which in this case were controlled by people from other parties in the centre-left coalition: Luigi Preti of PSU was Minister of Finance, and Antonio Giolitti of PSI was Minister of Budget and Planning. Overall, the Colombo cabinet was composed of a majority of DC people (16), followed by PSI (6), PSU (4), and only the Minister of Justice from the Republican Party, after La Malfa’s refusal to take the Treasury.  

The unofficial leader of the economic triad was Ferrari-Aggradi: not only did he represent the largest party in the coalition, but he also had the strongest background in economics (he was a professor of economic policy in Rome), while Preti and Giolitti held degrees in law, and subsequently exercised related professions, despite having been involved in economic ministries in previous cabinets during the 1960s.

From price stability to economic growth

As has been pointed out since Chapter 2, the most striking element of Guido Carli’s governorship at the Bank of Italy was the slight modification of the main focus of monetary policy, from the traditional price stability objective, to the idea that monetary policy had to play an active role in the promotion of economic growth. Such change was given very different evaluations from different scholars who later wrote on the Carli years; what is undeniable is that it was a significant shift in the role of the central bank. On the other hand, the government was facing a change in international conditions which somewhat weakened the country’s balance of payments position - ‘somewhat’ meaning that it had weakened its position according to the mainstream ideas of the time, which automatically catalogued a lower current account position as a weakness. What was actually going on was a sort of attempt by the government - or, to be more precise, of the different centre-left governments of the 1960s - to foster economic prosperity through higher public expenditure which, however, implied a deficit and inflation and, as was realized by government and public opinion in the very late 1960s, a loss of external competitiveness, measured in terms of real exchange rate, which lowered the balance of payments surplus.

Given what has been said as regards the relationship between the Bank of Italy and government, especially in terms of the de facto agenda setting power enjoyed by the former, it must not be forgotten that both politicians’ and Bank officials’ views had a political weight during these years, the former not being necessarily more influential than the latter in eventually shaping the country’s choices in the monetary field. Furthermore, as mentioned, Guido Carli was a DC himself, and belonged to the same corrente as Colombo.

In his inaugural speech, in early August 1970, Prime Minister Colombo spent a paragraph explaining the problems Italy would face in terms of monetary policy, and another paragraph sketching out the international political environment in which the government would operate. As to monetary policy, Colombo claimed that policymakers had to “act on economic grounds by fostering a realignment between the volume of domestic demand and the volume of supply, and avoid a reduction of investments while the economy is waiting for a rise in domestic production.” Indeed, even if “some people [tended] to think about monetary measures in the sense of a devaluation”,

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109 Ibid.
the Prime Minister believed that “such a decision would be a grave economic mistake which would increase our imbalance”.

As may be noted, the problems of the balance of payments were presented under the point of view of the recovery from the production crisis of the previous year, in line with the Bank’s belief in the cost-driven inflation hypothesis. In terms of monetary cooperation, Europe was not yet cited.

Colombo and Europe

In the paragraph on Italy’s foreign policy, among other things, Colombo pointed out that “In the most recent meetings at the Community level [the government] put the accent on the necessity of a parallelism between the progress to be made in the economic field and in the monetary field.″

This was all as regards monetary issues in terms of foreign policy. Notably, Colombo did not mention monetary issues in relation to the United States as he did in relation to Europe, perhaps a sign that the tide was changing. Furthermore, it must be noted that Ostpolitik - the “expansion of commercial, economic, cultural and human relations between Western and Eastern Europe” - was presented as an opportunity rather than a possible source of trouble, and the European Community was considered to have played a positive role in that respect: “contrary to malicious suspicions, the community structure itself, in making progress, ended up being a powerful incentive to such development.”

Of course, when thinking of international politics in the early 1970s, one could not but focus on the political side of European integration and West Germany’s Ostpolitik. Hence, as usual for those years, the speech failed to consider international monetary problems in depth. Perhaps it is not in the main public speeches that one ought to look for traces of the government’s position towards monetary choices. The issue was not considered to be a highly critical one at the time of the government’s inauguration.

Where is it that one should look for, then? If not in the government’s public speeches, it is in the dialogue between the Bank of Italy and the government that one is most likely to find traces of such reasoning. Indeed, the relationship between Bank and government had been consolidated in a practical consultation over monetary issues, in which the Bank defended long term goals while taking into account the government’s typically shorter term interests.

Such a long term attitude, during the 1960s and 1970s, had been intended in the sense that the Bank was also responsible for an economic growth goal, besides the traditional price stability objective that is implicit in an institution responsible for monetary emission. Such a growth objective, which has already been mentioned and explained, needs to be put in context. Economic growth has not always been seen as central to the management of a country’s economy. The reason why economic growth has become a tenet of economic policy, in Europe as well as in the remainder of the West, is that a relation between growth and employment has been affirmed, at a certain stage, in economic theory. Whether growth was state-driven as in the Keynesian form, whether it be driven by market forces and stimulated through the supply side, the fact of the matter was that, by the 1960s, it became clear that growth and inflation went together, and inflation in turn played a role in beating unemployment. Moreover, an even better reason to promote the idea of economic growth was the bipolar confrontation of East and West, of economic planning versus liberal capitalism.

Despite Spinelli and Fratianni’s accusations directed against the Governor’s focus on economic growth, it can be affirmed that he was simply following the general spirit of the time. At any rate, such focus translated into attention to the balance of payments being in surplus in its current account, the latter being directly correlated to the total

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111 ibid.
112 ibid.

113 "Let us suppose, for example, that the government believes it is convenient, for political and social reasons, to promote a strong development of certain sectors, for which it will be necessary to find convenient sources of funding as well as establish the practical ways to do it. The central bank will certainly be consulted, at this stage it will have to tell its own opinion and give its own advice, explaining the advantages and the short and long term consequences of this or that policy line. [...]" Renato De Matta and Antonio Finocchiaro, _La Banca d’Italia_, Rome, 1966, p. 119.
output figure.\textsuperscript{115} This implied an endorsement of export-led growth,\textsuperscript{116} thus highlighting the role of foreign trade, which in turn made fixed exchange rates useful and therefore defendable.

Colombo himself - a former Treasury Minister - as well as the economic triad of his cabinet (Ferrari-Aggradi plus the Socialists Preti and Giolitti), had showed a somewhat blind belief in the fixed exchange rates system. Quoting Colombo's inaugural speech of August 1970, it has already been noted that the incoming Prime Minister mentioned the role of fixed rates in keeping production costs down, so as not to create problems to enterprises, already in trouble because of the working hours lost as a consequence of strikes. One might have wanted to ask him, with a macroeconomics textbook at hand, why he did not consider the fact that a devaluation would have stimulated production by making Italian products cheaper: indeed, most economists of the time were already proposing export-led growth for countries like Italy, and most historians accepted it as a factor of the country's post-war boom. In fact, no one could buy Colombo's explanation as to why devaluation would increase the imbalance: in his view, devaluation "could not foster our exports, as these are stagnating because of a production deficit, and it would be the most unjust of taxes, which would weigh on consumers first, and then also on enterprises, because of the higher cost of foreign products."\textsuperscript{117} But if exports had been really sluggish due to a production deficit, devaluation would have certainly worked as an incentive to overcome such deficit.\textsuperscript{118}

Moreover, such an explanation is particularly untrue when one considers another significant problem that was due to fixed rates, and that he did not want to mention in the light of DC's official Americanism, that is to say, the evidence that inflation was being imported from abroad. This was a major cause of economic trouble resulting in higher production costs and lower competitiveness of Italian products, too. Why was this not taken into account?

\textsuperscript{115} Y = C + I + G + CA.
\textsuperscript{116} CA = EX-IM.
\textsuperscript{117} The higher cost of foreign products would not have impacted as much as it could have been transferred to the end user through the production chain, thus being offset by the higher exports, in the best case, and changing the consumer's preference basket, at the very worst.

Rather than offering an answer to this question, it is more interesting to offer some sketches of how this belief changed during the year that passed between this inaugural speech and the breakdown of Bretton Woods. Indeed, during the first half of 1971 the US balance of payments problems, with capital flows and the consequent world monetary instability, were reflected in the decision by Germany and the Netherlands to let their currencies float. Such events led other countries to consider doing the same, or at least realigning their own currencies - outside the IMF's Bretton Woods rules - by the percentage that was deemed necessary in order to restore the equilibrium, stop capital overflows, and jeopardize the risk of speculative attacks on the currencies.

In the wake of these events, Treasury Minister Ferrari-Aggradi's position, also backed by Governor Carli, was reported by Corriere della Sera on 8 July to be insisting on the need to "restore as soon as possible fixed and realistic parities within the Community." The newspaper went on deciphering some of the implications of the government and Bank's position: "if the Deutschmark were not revalued, under present circumstances Italy would not be able to accept a widening of the fluctuation range of European currencies against the dollar. Indeed, if the reform were put in place, with the mark back to its old parity, the Italian currency and the German currency, according to the specialists of the ECM, would immediately locate themselves 'at the two sides of the tunnel' formed by the fluctuation band against the dollar."\textsuperscript{119}

Such a position, with all its implications in terms of intra-European monetary choices, sheds some light on a detail that had not been specified in Colombo's inaugural speech, that is to say, Europe was not seen as an instrument of autonomy from the United States. Such a view reflected at least two concepts.

The first is that any European cooperation in monetary terms was not yet seen, as late as of July, as an alternative to Bretton Woods. The belief in fixed parities was still in place, as well as the attachment to the US dollar-based system.

The second, interesting point was that Italy's Europeanism was not an absolute: as soon as any project of European monetary cooperation turned out to be a burden for Italy, as would be the case with a monetary snake with unfavourable starting parities, as it would have already virtually been reached - According to voices, mark and guilder will be revalued". Corriere della Sera, 8 July 1971.
the country would not be willing to accept it simply on the grounds that it could be a progress towards Europe.

With the government and central bank relatively aligned on the nuts and bolts of the possible strategic solutions to the monetary puzzle, and the Communist bloc still insensitive to any discussion on international integration of any kind within Western-oriented schemes, Italy’s policy-making scene was entering the summer that would change the world’s monetary situation once and for all. The extreme left’s peculiar refusal to discuss any of these developments makes it interesting, and necessary, to take a look at what other pressure groups, outside the policy-making circles - especially the trade unions - might have to say on this issue, before moving on to describe the fundamental changes that were triggered by Nixon’s forthcoming decision on the fate of Bretton Woods.

CHAPTER 7
PRESSURE GROUPS AND MONETARY POLICY-MAKING IN ITALY BEFORE THE COLLAPSE OF BRETTON WOODS

The unconscious policy of the Scottish shower is not one that fits our society.1

-- Ugo La Malfa

1. THE COMPLEXITIES AND PECULIARITIES OF PRESSURE GROUPS IN POST-WAR ITALY

Besides those directly involved in policy-making, a number of external actors with a very different nature also came into play in the context of the monetary choices that Italy had to make in the late 1960s and early 1970s.

Of all these actors, trade unions played an exceptionally influential role, due to historical reasons that gave them an especially high leverage during those specific years.2 The main Italian trade unions shifted their views on international monetary regimes, from an initially suspicious position towards the fact that European monetary integration might be a good substitute for the not particularly beloved Bretton Woods system,3 to a later softening of such views in a more Europeanist fashion; a shift which

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1 Ugo La Malfa, L'altra Italia, Milano, 1975, p. 164.
3 According to a CGIL official, "by attributing a decisional function to central banks, [the Werner Plan] conceals to subtract the choices of economic policy, even more widely, from a debate that needs to be more open to trade unionist and democratic pressures." CGIL Archive, AandC, fasc. 154, 9 December 1970.
confederations decided to form a joint confederation, a choice that led them to be perceived as a single actor for the subsequent decades. Indeed, from that point onwards, the media came to use the expression “CGIL, CISL and UIL” almost as a synonym for “Italian trade unions”. Taken together, these three confederations’ positions were as central to the debate between workers and business owners as the positions of DC were to the Italian political scene of those years: so important that all other positions could only be complementary to theirs. Besides these three organizations, at the national level a certain influence was also enjoyed by a fourth confederation, the right-wing CISNAL, whose membership was composed of workers belonging to the so-called “social right”, but which never played a central role in any of the main policy choices that shaped the post-war political framework.

During the 1960s, all unions had become increasingly conscious of their potential role in influencing policy-making, faced with the great changes in domestic and international politics represented, respectively, by the advent of centre-left coalition governments in domestic politics and by the tendencies to intra-European international cooperation introduced by the EEC, they felt the need to find common lines of action and, in order to do so, they worked very closely with each other in order to find common grounds for their choices. The 1971 unification proved not to be easy for many differences still existed between the three confederations on important issues. The historical division of 1950 had not come out of thin air, and the cleavage between the Socialist inspiration of CGIL, the Social-Democratic attitude of UIL, and the Catholic orientation of CISL, was still very much at the centre of the debate on the possible points of contact, and the necessary points of dissent, that needed to be dealt with in the light of unification.

In trying to isolate which of these cleavages might be most useful in order to summarize the trade unions’ positions on international monetary issues, what stands out was in line with some other leftist actors in the Italian political scene, but which also had certain peculiar features.

At the other end of the industrial relations spectrum were the associations of business owners, in particular the five confederations. The Italian business during the 1960s showed at least two very widespread attitudes when it came to evaluate the economic conditions of the country. The first was the tendency to look at the international stage as a projection of - in this case a potential panacea for - the domestic troubles of the economy. The second was the widespread and substantially correct idea that the economic boom was coming to an end, and therefore Italy badly needed to find a way out of the forthcoming slump, an enlargement of the export market being a possible solution to such gloomy perspective, in the traditional “export-led growth” paradigm which had thus far been the strength of Italian business owners.

Finally, the financial world also exerted some influence. Despite not behaving as an organized pressure group, certain large interests made financial actors gather in a way that was very similar to that of the described pressure groups.

2. NEW LEVERAGE, BUT OLD PROBLEMS:
THE TRADE UNION MOVEMENT

Of the three largest confederations of trade unions that shaped the Italian post-war trade union framework, only one, CGIL, was already in place before World War II; suppressed by the fascist regime during the inter-war years, it had reopened in 1944. The other two, CISL and UIL, were both created in 1950 as a consequence of the anti-American positions taken by CGIL during the early post-war period. However, while acting on their own throughout the first two decades of their existence, in 1971 the three

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is that the three confederations' visions on the Phillips trade-off were broadly the same.14 Differences emerged when it came to the positions regarding trade, on which CGIL - detaching itself even from the traditional Socialist doctrine - promoted a sort of autarchic vision, in which trade across borders was seen as a potential threat to domestic industry, and therefore to domestic labour.15 On the contrary, UIL and CISL maintained an internationalist view, the leadership of both trade unions even being involved in Jean Monnet’s “Comité d’Action pour les Etats Unis d’Europe” as of 1965.16 Actually, UIL had a more sectoral membership17 and therefore, in theory, it might have exploited this feature at least in order to develop sector-specific views on trade policies; however, this did not seem to be the case in practice.18 On the issue of exchange rates, instead, the bone of contention, that had provoked the detachment of UIL and CISL at the beginning of the previous decade, came out with strength. While CGIL opposed both the Bretton Woods system and European monetary integration as a matter of ideology,19 UIL and CISL were not anti-American at all;20 moreover, as has just been pointed out, both of them showed a very positive attitude towards European integration.

14 Rather than openly preaching in the positive effect of inflation on the employment level, CGIL, CISL and UIL were factually supporting such view, since all three confederations pushed for higher nominal wages during the 1960s. Had Phillips been right, the inflationary effect of such pressures would have had a positive spill-over on the employment level, which was unfortunately not the case. For the original description of the Phillips trade-off, see Allan W. Phillips, “The relationship between unemployment and the rate of change of money wages in the UK 1861-1957”, Economica, 1958.
15 Mauro Maggiorani and Paolo Ferrari (eds.), L’Europa da Togliatti a Berlinguer: testimonianze e documenti 1945-1984, Bologna: Mulino, 2005. See also the extent to which this view was going to change in a matter of a few years, in Luciano Lama, Intervista sul sindacalismo, 1970, pp. 62-76.
20 On the contrary, as Bruno Manghi of CISL pointed out, the goal of moderate trade unionists should have been to “study how it might be possible to apply in Italy the model of trade unionism in the United States, that is, of a trade unionism which combines loyalty to the institutional system with a noteworthy drive toward industrial conflict and with great organizational efficiency.” Fabrizio Cicotti (ed.), La DC dopo il primo venentino, Padova: Marsilio, 1968, p. 108. See also F. Roy Willis, Italy Chooses Europe, Oxford: Oxford University Press, 1971, p. 239.

All these positions started to become increasingly significant and publicly debated while the decade went on, due to the combined action of the unification process, which made the unions much more visible at the national level,21 and of the organization of the movement, which during these years managed to reach very deep into the workplaces22 through the massive incentives to membership offered by the relative decline of the economy.23 On its side, the weakness of the national government, which made it incapable of coping with these organized groups of workers claiming reforms that were not always in the public or long-run interest, made scholars describe Italy as an “available state.”24 A country whose executive power was unable to say “no” to any request expressed with sufficient force. Moreover, cabinets were alternating at a pace of more than one per year and, although the centre-leftist formula of the quadripartito25 remained in place until 1970 and most times ministers were just switching positions from one cabinet to the next, this fluid situation did not offer guarantees of stability to anyone who really wanted to attempt a major programme of reform. This problem of limited governability became more and more significant for the country’s destiny - and to the theme of the current research - during the years from 1969 onwards.26

2.1. The “hot autumn” and its themes

In the autumn of 1969, the conflict between government and trade unions reached its apogee. In what would later be called the “hot autumn”, the working hours lost in the manufacturing industry because of strikes were more than 200 millions, breaking the previous record of 113 millions that had been reached in 1962.27 The problem at stake was the renewal of the collective contracts. There were two issues that made the process

22 Ibid., p. 52.
25 The quadripartito was conceived in two possible formulas, this one being the traditional centre-left, DC-PSI-PSDI-PRI, as opposed to the one sought by Giulio Andreotti in the formation of his first centre-right cabinet in 1972, DC-PLI-PSDI-PRI which was eventually formed by only three of the four parties, PRI having opted out.
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19 It should be enough to quote the tone of what was meant to be a CGIL "informative" memorandum on the Werner Plan: "If the Werner Plan, as an expression of the Community, can be considered an attempt to control part of the economic policies of the Member States, it also represents a concrete step towards the need - still in search for a satisfactory compromise - of an alliance of capitalism in front of common interests, i.e. the euro-dollar problem, the control of inflation and of the balance of payments." "Nota informativa sul Rapporto Werner in merito all'Unione Economica e Monetaria Europea?", CGIL Archive, December 1970.
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\textsuperscript{21} Mario Regini, "Labour Unions, Industrial Action, and Politics", in Peter Lange and Sidney Tarrow (eds.), Italy in Transition, London: 1980, p. 49.
\textsuperscript{22} Ibid., p. 52.
\textsuperscript{25} The quadripartito was conceived in two possible formulas, this one being the traditional centre-left, DC-PSI-PSDI-PRI, as opposed to the one sought by Giulio Andreotti in the formation of his first centre-right cabinet in 1972, DC-PDL-PSDI-PRI which was eventually formed by only three of the four parties, PRI having opted out.
\textsuperscript{27} Augusto Graziani (ed.), L'economia italiana dal 1945 a oggi, Bologna, 1979.
more violent than in the past. On the one hand, workers in many factories criticized 
CGIL for its alleged excess of centralization, and they did so by organizing independent 
strikes and demanding tailor-made contracts in each single factory. On the other hand, 
the trade unions’ leaders tried to maintain their leadership and overcome these claims by 
promoting new requests for larger reforms that, they pointed out, would not be possible 
to promote with a decentralized structure: the establishment of a right to having a home, 
social security, better conditions in the Mezzogiorno, public transportation. This 
action gave way to the so-called strikes for reforms, which added up to the decentralized 
conflict, with the final effect of raising the general level of social tension.

The way trade unions showed their interest in monetary issues is strictly 
consequential to their general views on economic policy. It is important to note here that 
views, not actual economic theory, were what mattered at that stage; as is always the 

case, in this field there was a gap between economically and politically desirable 
solutions. Hence, views were influenced by the political process; moreover, certain 
economic mechanisms had not yet been developed at that stage, or sometimes they had 
not yet been digested by policy-makers. Given all these factors, at least two aspects of 
economic policy were shaped in a way that invited trade unions to develop views 
regarding the monetary regime: the problem of inflation versus unemployment, and the 

debate regarding how best to manage the exchange rate.

Inflation and unemployment were believed to work as a trade-off, which also 
represents the quintessential example of a mechanism whose understanding played a 
very significant role in shaping policy views throughout the 1960s and 1970s. 
Regarding the general belief in the Phillips curve’s trade-off, and the role of economic 
planning, even as late as in the 1970s the official CGIL vulgata was that “The argument 
that an expansion of monetary supply, required in order to absorb the larger public 
deficit, would have inflationary consequences, is not sustainable as long as total demand 
remains well below potential supply, as is evident from the widespread and grave 
under-employment of the factors of production.”

The second bone of contention was the exchange rate, in both its optimum level and 
the best regime required in order to achieve it: under certain conditions - which Italy 
was experiencing - exchange rate volatility would have led to price volatility. Of course, 
if this view was sometimes adopted because of the belief in its theoretical validity, 
many other times it was just used as a façade in order to motivate ideological positions: 
indeed, it must be noted here that among trade unions, monetary issues were perceived 
as something connected to the more general theme of the fight between social classes, 
and more specifically, as secretary-general Agostino Novella put it at the VII Congress 
of CGIL in June 1969, as “the reflection of a deep process of redistribution of markets, 
and of new relationships of force in an international division of labour which is 
favourable to large monopolistic groups, especially those from the United States.”

The unions’ position towards European monetary integration was also problematic 
because of the fear that the subsequent loss of monetary policy autonomy might have 
diminished their own leverage in terms of influence on policy-making. Obviously, this 
was a very concrete fear in the 1970s, a time in which it would have been unthinkable to 
organize the trade unions’ movement on a European scale, in order to build a positive 
dialogue with the prospective European centralized system of central banks which 
would have been responsible for monetary policy-making in the case of the adoption of 
a Werner Plan-like monetary arrangement.

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25 Ibid.
31 In attributing a decisional function to central banks, [the Werner Plan] helps even more widely to subtract the choices of economic policy to a debate more open to trade unions’ and democratic pressures.” CGIL, Archive, Atti e Corrispondenza, Fasc. 154, Memorandum on the Werner Plan, p. 2, 9 December 1970.
2.2. Unity of trade unions and cooperation at the EEC level

This anti-Europeanist reaction was followed by the events of 1968 and 1969, which gave the unions some new hints as to how powerful the organization of masses of workers could be in order to exert pressure on the government.37 One of the most direct consequences of this discovery was, as mentioned earlier, the intention of the three main trade unions to gather and form a united federation. The issue of trade unions' unity was closely linked to that of their higher political leverage: "We feel that these objectives and these fights derive from a stronger force of the trade unions movement. [...]"38 Indeed, secretary Novella claimed that CGIL was "firmly committed to guarantee continuity and development to the unitary process, convinced that such process needs not always be linear; rather, it needs to be implemented 'while it is hot', in the fire of the fight and of the open confrontation, making every new unitary acquisition rest on the democratic will of the workers' mass."39

Moreover, in the opening remarks of this congress, UIL leader Italo Viglianesi raised an important causal link between the process of European integration and the need for trade unions unity, as "the technological revolution, European economic integration, the Planning, compelled the workers' movement to make choices no longer fragmented, if such movement really wanted to become the main provider of social transformation."40

Similar opinions regarding the acknowledgement of the trade unions' potential, as well as their role in the active participation of the masses in the country's political life, had already been expressed in a press statement jointly released by the three confederations CGIL, CISL and UIL in October 1969, at the very beginning of the "hot autumn", and which can be seen as a sign of the times:

Finally, the three Confederations underline, in this occasion of lively trade union fights, the civil and democratic function of the workers' movement. The ongoing fights are being

devolved with an active participation of the masses, which is not limited to the implementation of strikes, but is extended to a whole spectrum of tasks, from the elaboration of claims to the choice of the forms of fight. It is a firm intention of the trade unions to make the participation of workers to its decisions and political choices become a permanent feature.41

Regarding Europe, UIL secretary Viglianesi mentioned the problem of the lack of presence of trade unions in the EEC institutions. Such lack of presence was accompanied by the problem that, although a European Confederation of Trade Unions already existed, it was in no way organized as a national trade union, and it looked like a network rather than an active body.42

Commenting on the issue of European integration - which, as already shown in Viglianesi's words, was usually seen as a problem instead of an opportunity - CGIL secretary Novella specified once again that the reason for such treatment was not the unions' opposition to the EEC, since "our position, as CGIL, has always been that of recognizing the objective nature of the processes of economic integration in Europe."43 Rather, there had been a voluntary neglect due to the fact that the Italian unions criticized "the absolute preponderance of the interests of the big international monopolies in the structure and politics of the European Economic Community."44

All in all, the Italian trade unions' perspective was Socialist in both its nature and lexicon, even though it lacked the internationalist approach that was so typical of the Socialist politicians of the time,45 including those belonging to the different Italian Socialist parties,46 especially since the 1960s, when they became key governmental

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39 Ibid.
40 UIL Archive, V Congresso Confedrale, Relazione Introdottriva, 27 October 1969.
41 UIL Archive, Comunicato Congiunto della UIL, CISL e CGIL sulle Lotte Rivendicative, attached to UIL document no. 2081, p. 451/452, 1 October 1969.
44 Ibid.
way we were breaking a communication channel which would have been useful to both the trade unions themselves and to the general political equilibrium.\textsuperscript{50}

In a totally different tone, several years later, in the speech delivered at his party’s congress of November 1971, PRI secretary Ugo La Malfa described Lama as bearing the main responsibility for the crisis: “We made clear to the secretary of CGIL, Lama, [...] that it would have been better to show such inclination before the hot autumn, and not afterwards. The general condition of the working classes would have been today incomparably better.”\textsuperscript{52}

La Malfa tackled the issue of the economic crisis from the assumption that “in the modern economy, the best condition for the solution of [...] problems cannot derive from agitations and strikes [...].”\textsuperscript{53} It is perhaps the case to specify on what economic grounds La Malfa was speaking: during the period of social uprisings that took place in the two final years of the decade, the government showed an inability to say ‘no’ - showing the image of a state prone to any demand, if represented with enough violence - which ended up in artificial imbalances to the structure of wages and, in turn, in prices\textsuperscript{54}; “For a long time it has been denied that a certain type of action by politicians and trade unionists, not really in line with the objective possibilities that the economic system was able to offer, would have ended up weakening it, giving a result contrary to what was wanted. [...].”\textsuperscript{55} This worsened the country’s competitiveness and exacerbated the problems related to unemployment and economic stagnation, without even raising the purchasing power of the same working classes that had occupied the streets asking for higher wages. Had this been limited rather than pumped up by trade unions leaders, La Malfa claimed, everyone would have been better off, workers first.

\textsuperscript{47} After being excluded from government in 1947 as an American condition for the Marshall Plan, the softer Social-democratic party, PSDI was already back in the De Gasperi cabinet in 1948, and the traditional Socialist party, PSI was often part of the government since the first Moro cabinet in 1963.


\textsuperscript{50} Ugo La Malfa, \textit{L’altra Italia}, Milano, 1975, p. 164.


\textsuperscript{52} Ugo La Malfa, \textit{L’altra Italia}, Milano, 1975, p. 164.

\textsuperscript{53} Ibid., pp.162-164.


\textsuperscript{55} Ugo La Malfa, \textit{L’altra Italia}, Milano, 1975, pp.162-164.
3. THE ORGANIZED BUSINESS BETWEEN SECTORAL INTERESTS AND STATE MANAGEMENT

The main business associations in the Italy of the 1960s were the two confederations of industrial producers, Confindustria for the private sector and Intersind representing State-controlled enterprises; the smaller confederation of commerce, Concommercio, which to some extent ended up being a projection of Confindustria since offering membership to the association of large-scale retail distributors in the 1950s, and the two confederations of agricultural producers, respectively Confagricoltura for large-scale production, and Coldiretti for the small business.

Confindustria, a business association among industrial employers, founded in 1910, had been able to survive during the Fascist regime thanks to its willingness to operate within its boundaries; it maintained a paramount influence as a pressure group in post-war Italy, being the main port of call for Italian private industry from all sectors and of every size. Besides the obvious political leverage stemming from the role of industry in the country's economic growth, policy-makers had a second reason for paying special attention to Confindustria, namely the latter's continuous debate with trade unions. On the one hand, the business association was seen by the more moderate policy-makers sometimes as an ally against the excessive demands put forward by trade unionists, in an escalation reaching its apogee in the "hot autumn" and the subsequent years, some other times as a potential threat due to its ability to find common grounds with CGIL, CISL and UIL on certain themes on which common pressures were then exercised towards the government. On the other hand, policy-makers more oriented towards the left had an opposite view of the same patterns of political pressure. This, of course, did not prevent policy-makers, as well as Confindustria itself, from acknowledging that a general long-term loss of influence was being experienced by the business association, as a consequence of the contemporary rise in political leverage by the trade unions.

Intersind was the business association of State-controlled enterprises, that is, of those enterprises the majority of whose capital was controlled by the State. Its history began in 1956, when the DC cabinet led by Antonio Segni proposed a law for the creation of a Ministry of State Participations in order to take care of the management of State investment in those companies which, their product being recognized as a public utility, were seen as a projection of the role of the State in ensuring the development of the country. A law was finally approved in December 1956, with the inclusion of an amendment stating that such companies would also be required to withdraw from any business association they might belong to. Such withdrawal took place in 1958, and was accompanied by bitter criticism from Confindustria. The creation of Intersind took place two years later, on 24 May 1960, as an association between a group of enterprises controlled by the Istituto per la Ricostruzione Industriale (IRI), the public holding in charge of the management of most State-controlled enterprises.

The positions of the association of commercial activities, Concommercio, were mostly aligned with Confindustria's views in every field of policy. This was due to historical reasons: while the confederation had been born as an independent body and it maintained, in fact, a distance from the other business associations until the 1950s, during this decade, as a consequence of accepting the membership of the association of

64 Ministero delle Partecipazioni Statali, Circolare Appaltativa, 15 November 1957.
65 Ada Collidà, "L'Intersind", in Ada Collidà, Lucio De Carlìni, Gianfranco Mossetto and Renzo Stefanel, La politica del padronato italiano: Dalla ricostruzione all'"autunno caldo", Bari, 1972, p. 91.
66 Art. 3, law no. XX of 20 December 1956.
68 Ibid., p. 227.
large retail distributors - which was controlled by some of the main companies that formed Confindustria, it was in practice taken over by Confindustria itself.

Confagricoltura was the business association for the agricultural business; it had been an all-encompassing confederation until 1944, at which time the Christian Democrat Paolo Bonomi organized a secession of the smaller-scale producers and created Coldiretti. To be fair, the position of the entire agricultural sector towards monetary issues during the 1960s was much more influenced by the debate on the EEC’s Common Agricultural Policy than by the ups and downs of Bretton Woods. In the final determination of the influence of the foreign environment into the domestic economy, indeed, elements such as the protection of agricultural production through trade barriers accounted for a much larger share of the risk associated to international trade than did any monetary regime shift.

3.1. Key drivers during the 1960s

Over time, it seems that the most important variables that shaped business views regarding the international side of monetary policy have been four: the level of interest rates, the choice regarding trade patterns, the new role of inflation and, of course, the implications of exchange rate stability or lack thereof.

The interest rate

As has been pointed out, the central bank’s policy during the 1960s had been that of a strenuous defence of interest rate steadiness. On the one hand, this was positively welcomed by industrial producers, who would suffer from possible changes in the conditions of availability of finance in the domestic economy. It must be pointed out that most Italian industry was either self-financed, or financed through bank lending. A rise in interest rates would therefore diminish investment due to the higher cost of capital for those firms using the latter type of finance: “Those who, over the years, have invested in private and State bonds have been threatened by the devaluation of the currency and, recently, also by a substantial lowering of rates. [...] In such a situation, it is not possible to avoid a capital flight towards abroad, something all of us must condemn; but above all we must condemn the policy which led to it.”

On the other hand, however, sticky interest rates sometimes played against domestic production itself. Indeed, it is a matter of fact that lower rates would stimulate the availability of the capital that would move out of investments in State bonds, for which at the time a huge market had developed, due to the Italian State-controlled enterprise having been tentatively financed through this channel.

Private industry was averse to state enterprise for its limitation to the free operation of markets. In criticizing the expansion of capital usage by State-controlled industry, Torrelo Giani drew a trade-off between capital available to public and private enterprises. Such trade-off would only work if the total capital available were simply a function of exogenous elements such as capital flights due to monetary policy. Despite this being a total heresy in terms of financial theory, it must be pointed out that it was actually very rational to think in these terms as of 1967. Indeed, Italian private enterprises, with very few exceptions, could not raise capital in the financial markets, the domestic financial market having a risible size.

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69 Ibid.
75 Obviously, indeed, capital can be created, for example by enhancing financial markets through the securitization of debt, companies going public as opposed to using bank lending, relationship lending as opposed to one-off loans, and a host of other ways.
Favourable foreign trade patterns

If it is true that not every Confindustria member was export-led or import-dependent, one must however acknowledge that, either from the production side or from the market side, the question of international trade involved most of them.78 In this light, the choice of the international monetary regime might have a further impact on a country’s foreign trade: different regimes, by creating different conditions for marketing products among some groups of countries rather than among others, would end up affecting the existing patterns of trade.79

Eventually, the problem for an all-encompassing agency like Confindustria was to isolate which trade patterns would bring the most advantage to its own members; moreover, the fact that the exchange rate regime debate almost always came together with the more general debate on European integration - another alternative to Bretton Woods not being envisaged at the time - made the issue more complicated than it already was. Indeed, European integration included plenty of other trade barriers, too: besides tariffs and quotas, the problem included the liberalization of domestic markets, the mobilization of factors of production, the harmonization of regulation, and so forth. Confindustria took a very positive attitude towards this, in the belief that harmonized markets would lead to free competition, and implicitly, to the erosion of state monopolies in certain public utilities and strategically relevant sectors. This point explains why industrial producers were still pushing for further progress on these aspects of integration as of early 1967, by claiming that “the spirit and the word of the Rome Treaty must not limit themselves, nor can they be limited to, a customs union or the creation of a free trade area. It is necessary to look beyond and let the economies of the Common Market countries reach such a harmonization as to enable the creation of a real common market: that is, to allow for the balancing of competitive positions.”80

On the problem of trade patterns, the international orientation of the State-controlled business came into play, but in the opposite direction from Confindustria’s: indeed, the State-controlled enterprises’ interests were much more unitary.81 Most of their international business, due to their nature - think of public utilities and heavy industry - was already oriented in the direction of other EEC countries, most notably France and Germany.82 In theory, a shift to a Europe-wide market would not meet the general interests of state-owned industry, whose profitability was based on monopolistic power. In practice, though, there was an exception: in the case of European monetary integration, being rather oriented towards the same foreign markets which would benefit from the change, a shift in trade patterns favourable to trade with these countries would encounter the favour of Intersind.83

Moving on to commerce, it must be noted that Italy’s trade balance was the real point of strength in the country’s balance of payments. At the top of a list of negative elements quoted by Concommercio president Angelo Casaltoli in 1966 stood capital outflows, “which created a balance of payments deficit despite the brilliant performance of the trade balance”.84 And one needs not dwell on the very late years of the decade, when this problem had indeed become very prominent: already in early 1966, the National Council for the Economy and Labour (CNEIL) stressed that a strong commercial sector, coupled with a structural lack of demand, would become a weakening, rather than strengthening, factor of the economy “only in the case it were obtained through a waste of resources”. At the same time, the CNEIL stressed that there was no sign that this was the case for Italy. Hence, “[...] far from suggesting a Malthusian policy of export restriction, it is necessary to aim at promoting imports, too. To this end, the main measure is still that of raising the investment level.”85 Concommercio’s position was therefore one of relentless promotion of international trade.

The promotion of new trade patterns was an issue on which Confagricoltura had a slightly more complex position. Due to the climatic and geographical complexity of the

country, domestic production was insufficient to cover domestic demand: a phenomenon common to Europe as a whole, as *Mondo Agricolo* often reported. Most international trade in agriculture was therefore oriented in a single direction, that of importing goods from abroad. The problem with foreign production was that agricultural commodities imported from America and Africa were much cheaper than domestic production. A monetary system - which potentially made trade with the United States relatively more difficult than trade with Europe - could not, therefore, be other than welcome to Confagricoltura, which saw overseas countries as the worst possible threat to local production. When the EEC, in June 1971, offered a 50 per cent reduction of the custom tariff for the imports of oranges from the United States, as part of a cross-exchange of tariff reductions involving other sectors, Confagricoltura reacted with decision: "the advantages the United States would enjoy would certainly be much smaller than the damages caused to our own production. [...] Confagricoltura cannot but underline the absurdity of a measure which, in order to sustain the economy of certain areas of Italy unjustly suffering from protectionist measures implemented by the USA, tend to load the burden on other areas of the South [...]."87

*Rising inflation*

Regarding inflation, the association of industrial producers had a position somewhat similar to that of trade unions: when the general level of prices rose, industry was under pressure on the production side; raw materials cost more, and wages were put under upward pressure. When inflation came, the typical industrial strategy until the early 1960s was to try to load the loss toward consumers, through higher prices, and toward employees through resistance against upward wage adjustments.88 In this way, the distribution of profit remained favourable to producers. As the 1960s progressed, however, the trade union movement started to behave more and more actively in promoting its own interests, especially in terms of social reforms and wage claims.89 At the same time, inflation started to rise, and industrial producers loaded trade unionists with the main responsibility for this phenomenon: the mainstream view, as expressed in an editorial of *L’Organizzazione Industriale* in January 1966, was that it would be "neither thinkable nor desirable to have a type of economic development based on salary dynamics, as this is the premise to an uncontrolled rise of prices, leading to a policy of inflation, and to the growth of the already well-known difficulties of the productive sectors, with the subsequent [...] contraction of employment."90 But of course, the negative effects of inflation would not only come from its being induced by redistributive pressures operating through the unions’ wage claims. In a television debate of 1967, Confindustria’s president Angelo Costa specified that inflation was induced by the fact that production costs did not fall adequately, and that "if wages were made to rise at the same pace as productivity, they would not create inflation."91

As was predictable, then, the industrial producers’ position on inflation was that its occurrence was a bad sign - for their own activity as well as for the whole economy - insofar as it was outpaced by the growth of the other production factors, mainly the cost of labour, due to an overshooting effect caused by social pressures. Such a phenomenon took place regardless of the causes of inflation, be they domestic or international. When the decade came to a close, indeed, Confindustria started to be afraid of foreign induced inflation too, calling for domestic monetary policy to play a role in finding a solution to contain this problem.92

On inflation, the State-controlled industry’s position was all the more in line with the anti-inflationary stance of Confindustria. As regards commercial activities, problems emerged when certain components of the price index grew more than others, in a way unfavourable to commercial businesses. Confcommercio’s president Casaltoli, in mid-1966, commenting on the economic data of the previous semester, pointed out that

92 RAI-TV, *Tribuna Politecnica*, debate between Confindustria and trade unions, 6 March 1967.
93 *L’Organizzazione Industriale*, 27 January 1966, p. 3.
inflation might soon become a problem for the commercial sector too, even if thus far “the evident stabilization of retail prices that took place despite the presence of tendencies to rise in all the components that contribute to form the distribution cost shows that the commercial sector, despite some latent symptoms of hardship, continued to absorb inflationary pressures [...]”.

All other things being equal, agriculture had to fear less than other sectors from the bad effects of inflation. But this element was softened by the fact that the prices concurring to the formation of the price index did not grow together, and in particular, they tended to put agricultural commodities at a comparative disadvantage. Hence the claims, often repeated throughout the 1960s, that agriculture required particular attention as the producers in this sector were “the new poor of Italian society”, as Confagricoltura president Alfonso Gaetani effectively summarized. Hence, despite all theoretical differences, inflation ended up having the same negative impact on agriculture as it had on the remainder of the productive sector.

**Exchange rate stability**

Another issue with which organized business was concerned in an unambiguous direction was the problem of exchange rates. This was not really an issue during the early 1960s, while it started to be discussed towards the end of the decade, when the Breton Woods fixed rates system started to weaken.

In late 1967, when the Special Drawing Rights proposal started to be discussed within the International Monetary Fund, Confindustria agreed on the fact that “a flexible system should be adopted, through fixing a ratio between gold and reserves, comprised within an upper and a lower limit”. In this, the association’s leadership was in line with the Italian government’s position, aimed at guaranteeing the larger freedom of action that would be necessary to the government in order to restore equilibrium in the balance of payments.

The problem of monetary stability started to be especially perceived in the industrial world when the time came to discuss European monetary integration, the main driver of this interest being one of the natural consequences of such integration, that is, the convergence of economic policies within the “small Europe” of the six members of the EEC. In April 1969, Confindustria’s position on this issue was that “the quickest way to implement monetary integration, that is to say, the unification of currencies, is precluded. There is no alternative but to pursue this goal indirectly, and step by step. In this light, an important instrument is the harmonization of economic policies in both the short […] and the medium term.”

Commenting on the presentation of the different proposals for staged European monetary integration that were debated in the early months of 1970 within the EEC, then, Confindustria expressed a definitely positive view towards such a possibility, wishing “that the good will may end up translating - quickly translating - into the expected solutions: which is to say, that the European dynamism may not run aground into the seabed of problems pertaining the sphere of ‘prestige’, or be smashed against the obstacles of national sovereignties.”

Regarding the exchange rate regime, Intersind too was strongly opposed to exchange rate floating. However, State-controlled enterprises had more than one reason to fear, if not monetary cooperation, certainly European integration as a whole, the latter being a broad, tidal process involving other issues such as market liberalization and competitiveness. In fact, these were allegedly the most influential enemies of the Italian
State-controlled business, if Confindustria's president Angelo Costa, in his annual speech of early 1968, claimed that "The State [...] has implemented a policy of capital destruction. [...] The State has kept passive firms alive in competition with healthy firms: in this case the damage which results in the passive firms' budget is minimal relative to the indirect damage, namely the destruction or missed creation of capital due to the competition exercised by firms which may lose indefinitely, distributing their own losses on the entire country."105

As to exchange rate stability and the rise and fall of certain patterns of international trade, it is possible to say that the focus of Confindustria was constantly placed on the reduction of trade barriers,106 as such, it certainly looked favourably upon the progress of the European common market, and it conceived the monetary union as a by-product of it.106

The reflections of the devaluation of several European currencies in the late 1960s on Confindustria's positions were well expressed by Il Giornale del Commercio which, describing the economic situation in late 1969, stressed that "The thesis of the revaluation of the Lira has lost grip as of late, after the balance of payments became negative as an effect of capital outflows and after the price indexes started to rise again; instead, the debate concentrated again on the possibility of devaluation, not as a probable event, but as a danger that appeared on the horizon, which has to be avoided with appropriate and timely remedies."106

3.2. Similarities, differences, and shifting views in the early 1970s

The way the business associations described here influenced policy-makers is complex and, of course, absolutely not structured: acting as interest groups, each of them did all that was in its powers in order to lobby the key people in the government, either through collective bargaining, the placement of people in strategic positions - in governmental positions, in the parliament, even in local councils - and, finally, personal relationships.107 Despite the complexity of the policy-making pattern resulting from this informal way of doing business, undeniably the final outcome of policy was facilitated for those instances in which a certain number of different pressure groups ended up lobbying for similar objectives.

As to inflation, there was a wide opposition front formed by the three industrial associations, Confindustria, Intersind and Confermo. While Confagricoltura and Coldiretti did not look at inflation in a necessarily bad light in theoretical terms, their position was never openly different from the other associations' in this respect. The overall figure was therefore an opposition to the inflationary trends of the 1960s. In this sense, the argument that inflation was being imported from the United States through the gold exchange standard had a certain appeal insofar as this became part of a more general, mercantilist reasoning which opposed the U.S. policy regarding trade with abroad, mainly in the agricultural sector.108

As has been noted, interest rates were an issue with which only industrial producers seemed to be concerned: indeed, they represented the most capital intensive sector, and the one which might have been most damaged when capital availability was jeopardized by outflows. The fact that industrial producers were responsible for a majority share of the country’s economic growth made policy-makers very sensitive to this position, and interest rate stability was guaranteed for the majority of the 1960s.109 Moreover, it must be added that the large and small scale agricultural producers could not but benefit from the positions expressed by the industrial producers in this area.110


106 For instance, "La liberalizzazione degli scambi e lo sviluppo delle esportazioni", Il Giornale del Commercio, 5 March 1968, p. 3.

107 For instance, "Garantire l'espansione del commercio mondiale", Il Giornale del Commercio, 18 January 1969, p. 3.


109 A paramount role was played by two informal methods of pressure, the parentela and the clientela. Joseph LaPalombara, Interest Groups in Italian Politics, Princeton, 1964.

110 "Diciamo tutta la verità sui rapporti CEE-USA", Mondo Agricolo, 26 December 1971, p. 5.

111 The discount rate remained fixed at 3.5% from 1958 until 1969, when it was raised by 0.5% to reach 4%, to then reach peaks of 5.5% in 1970 and 6.5% in 1973. Historical data series are available online from the United Nations Statistics Division, http://unstats.un.org/unsd.
While no association had a theoretical or ideological reason to support the stability of exchange rates, all of them ended up supporting it in some way. Confindustria and Confcommercio were attached to the idea that a European monetary system would serve their own interest better than the existing Bretton Woods system.111 Intersind took the opposite stance but still defended exchange rate stability.112 The agricultural business associations did not have a particular view on stable exchange rates.

What the latter associations had developed, in turn, was a position favourable to any change that would threaten the existing trade patterns with overseas countries, due to the lower production costs faced by U.S. agricultural producers.113 A shift towards European-based monetary solutions was seen as the possibility of forming a common front for the protection of domestic agricultural production, a common front that was being formed with the birth of the Common Agricultural Policy within the EEC.114

On the subject of trade patterns, Confindustria (followed by Confcommercio) and Intersind had views contrary to each other: the former supported a liberalization of European trade in a general context of no change in trade patterns; the latter had problems with such liberalization, fearing that this would start a process of integration leading to an erosion of state power,115 although remaining in general positive towards Europe, for reasons more connected to the general internationalist stance of the government of these years than to an economic advantage specific to the public enterprise.116

Of these four issues, the positions emerging from the first and the fourth pointed towards a general shift of attention towards the regional project of European integration than to the “one world” solution offered by the supporters of the existing Bretton Woods system.117 The third, instead, seemed to host a debate between who should be the provider of stable exchange rates, with the three industrial associations on opposite positions as to the role of the US in this sense.118 Finally, as to the second issue, the general support for stable interest rates, mainly promoted by Confindustria and Intersind, left the question open as to what international monetary arrangement would help the national government in maintaining such stability.

Eventually, the description of the Italian business associations’ scene as a plurality of subjects divided by, mainly, sectoral interests is probably not the best way to conceive the general picture of this aspect of the country’s political and economic life. In fact, if there was indeed a cleavage in Italian business, this cleavage was represented by large versus small firms rather than industry versus agriculture.119 The difference between State-controlled and private business itself, which has even been so much stressed by most historiography,120 is definitely less of a determinant than the divide between the limited number of very large firms which dominated every aspect of the country’s political life and the huge constellation of small businesses which would mostly follow the political choices of the large industry.

Luckily for the present research, while the existence of such a cleavage determined a differentiation of positions on many issues - think of State subsidies to small-scale agriculture, incentives to the creation of new firms, and so forth - it was not so paramount in the case of the positions on the monetary choices dealt with here.

Although secondary in relation to the previously mentioned cleavage, the previously described rift between State-controlled and private industry carried a few more consequences in terms of monetary positions. As has been noted, State-controlled firms were afraid of the consequences of European integration on their own market positions. While the whole business associations bloc was favourable to a liberalized Europe with a preferential exchange rate system, the containment of inflation and a truly continental

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113 Mondo Agricolo, 26 December 1971, p. 5.
117 With the expression “one world”, policy-makers meant the solution that would have saved the existing worldwide monetary system, as is apparent in British declassified memoranda in which the Bank of England's officials used this term. For instance, see “Steering Brief for Currency Conference”, TNA T312/3365, no. 59, 16 August 1971.

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capital market, with stable rates, which would have enhanced the availability of capital for investment. Intersind had some reservations on some points, and was clearly less interested on others. In terms of the liberalization of exchanges with Europe, while even the largest private companies such as Fiat smoothened their own positions towards foreign trade as the years went on121 - and their own competitiveness relative to foreign markets increased122 - in the case of the State-controlled business the problem was structural: competitiveness in free markets would never be achieved by companies whose business was inherently based on monopoly. Hence, either liberalization of trade and the creation of a monetary area in Europe was not so welcome to the State-controlled business represented by Intersind. On inflation and capital availability, it must be pointed out that they were never really a problem directly feared by these firms, as they enjoyed many instruments of protection against the odds of monetary variables: market power enabled them to transfer the costs of inflation on customers, and the issue of capital availability was always addressed through public collection of long-term capital.

4. SLOW DEVELOPMENT: THE ITALIAN FINANCIAL SYSTEM

Unlike other countries, in the Italy of the 1960s there was no - nor, actually, is there nowadays - a recognizable financial entity such as the City of London in the United Kingdom: an interest group at the same time unitary in terms of views, and plural in terms of actors.123 The Italian financial system, perhaps the only part of the economy which managed to go through the twenty years of the Fascist dictatorship without ever seeing its own interests driven into jeopardy,124 was still very backward. As of the beginning of the 1970s, the main function of the stock market was simply the formation of prices as opposed to being an opportunity for large and small companies to find ways to get financed by going public.125 The three largest banks, Banca Commerciale, Credito Italiano and Banco di Roma, were in the hands of the IRI holding, which basically represented the government's arm into the market economy.126 There was only one private investment bank, Mediobanca;127 their leaders Mattioli and Cuccia, due to the nature of the system, could not but have close ties with Christian Democrat and Socialist politicians.128

As to the mechanism of channelling savings towards investment, Italy was a quintessential example of how an economy could throw itself into backwardness through the lack of effective policy-making, or even through the adverse effect of it. On the one hand, the public sector was in constant expansion and it managed to finance itself through inflation-boosting seigniorage as well as the issuance of long-term bonds with which it financed investment in the large state-controlled companies managed by party people.129 On the other hand, stock exchanges were not as widespread as in the other Western countries, and as a result, the economy's only means of raising funds for investment was unambiguously bank lending - and the main banks, as has been said, were indirectly in the hands of the state through IRI.130

It is in this framework that one must investigate where the interest of the financial system stood in terms of the development of new equilibria in the international monetary regime.

4.1. Domestic factors: inflation and the interest rate

The state of the art of bank lending in Italy was mainly composed of the easiest form of lending, in which small private firms borrowed amounts of money that they would repay at a fixed rate. As has been pointed out, the public sector too was in search of

121 Giovanni Agnelli, L'imprese e le sue responsabilità, mimeo, Ischia 1969.
122 Giovanni Agnelli, “Gli operatori privati di fronte alla programmazione economica e alla integrazione europea”, in Movimento Europeo, Programmazioni regionali e nazionali e programmazione europea, mimeo, Torino 1968.
funds, and it did so by issuing long-term bonds, mainly at a fixed rate. Hence, none of these subjects depended on rates adjustable to the inflation level. Long-term bonds, however, differed from bank lending in their being adjustable to the interest rate. At the same time, however, private borrowers developed a preference for low interest rates, too, as banks obviously adjusted the interest rate of new loans to the projections of the future interest rate. Furthermore, private actors were playing the role of lenders to the state, by investing their own savings into state-issued bonds, an activity more and more profitable while the interest rates grew.

As is easy to imagine, then, neither the banking nor the public sector had a particular interest in keeping inflation down (if the described phenomenon had been the only problem attached to inflation), while everyone would have wanted low interest rates, except the private actors while playing the role of lenders to the state.

4.2. External factors: exchange rate stability and the pattern of foreign trade

As has been pointed out when dealing with business associations, the stability of the exchange rate does not only affect those who have stakes in foreign trade: when capital is free to flow across borders, a stable exchange rate makes sure that there can be no speculation in foreign currency trading, thus avoiding massive capital flows that may force interest rates to adjust steeply, with potentially devastating consequences to the economies involved. While, on the contrary, the pattern of foreign trade of a country is inherently a concern limited to those who trade abroad, as has been pointed out, these foreign traders actually operate in the domestic economy and will behave differently in presence of different foreign patterns of trade; hence, a shift in the foreign trade pattern of a country does affect the latter's domestic economy in all those sectors which are not completely circumscribed within the national boundaries.

When looking at financial actors, clearly then exchange rate instability is not a best choice, insofar as the subsequent volatility of interest rates may negatively affect the business conditions in the banking sector, not to mention the forecasts upon which the evaluations on the long-term bonds were based. For the same reason, shifts in trade patterns were not looked at positively, as they meant uncertainty, and uncertainty impacts on the pricing structure. A fixed exchange rates system was therefore seen as preferable.

However, in his mid-1960s theorization of the “impossible trinity”, Robert Mundell implied that exchange rate stability put a country in front of the choice between free capital flows or the possibility to use monetary policy in order to manage domestic variables. Looking at these goals, it is easy to reach the conclusion that in the context of the Italian economy of the 1960s, each of them was exactly about the two elements discussed above as domestically significant: free capital flows implied that the domestic interest rate would be sacrificed in order to match the world benchmark so as to avoid massive speculative inflows or outflows of capital, hence depending on the swings of larger rate-makers like the United States and Germany; in the domestic policy situation of the late 1960s, with trade unions rallying on the streets for higher wages, rising production costs, missed opportunities to modernize the economy, to contain the galloping inflation would be the main goal of a monetary policy free from the commitment to abide by the rules of Bretton Woods. Translating this reasoning into the viewpoint of a financial intermediary - say, Mediobanca or IRI, or the state itself while raising funds among the public - freedom of capital flows would stabilize the system only insofar as the Italian rate ended up depending on a country, or a pool of countries, with a clearly established interest rates discipline; moreover, on the containment of inflation, it is necessary to amend the statement made above about the fact that such action was not necessarily significant for the financial sector. Indeed, high inflation brought upward pressure on interest rates, while the preference of these actors, as has been discussed, was either for stability or low rates.
Perhaps, then, exchange rate stability itself represented the least necessary element of
the trinity in the eyes of financial intermediaries, provided that the foreign interest rate
upon which Italy would have to adjust its own in a world of floating rates - should have
been a stable one. The United States did not prove to be the most stable rate-maker,
especially since the Johnson administration. This made the project for monetary
integration among the countries of the EEC all the more appealing. It would still have
been a fixed exchange rate system, meaning that national economies would have to
sacrifice monetary policy in order to maintain the exchange rate within a narrow range
above or below the parity; but the monetary project would have linked Italy to more
prosperous countries, in company of which it would have been more likely to beat the
inflationary pressures that were present throughout Europe in those years.

However, the state-controlled nature of the main banks and financial holdings, as well
as the role played by state-issued bonds especially in the context of the economic
planning introduced after 1963 with the advent of Aldo Moro’s centrosinistra, did not
make such preference for a European-centred system as obvious as in the above
description. Indeed, the ties of finance with politics made economics less important
relative to political considerations such as the necessity to remain loyal to the
transatlantic ally: an element which, no matter how economically convenient, helped
keep the Communist opposition relegated to the far left of the political spectrum; which in turn was necessary for Moro in order to justify the inclusion of the Socialist
parties into the government to the right-wing of the Christian Democratic spectrum, that
asked for a clear line of political demarcation of which aspects of leftist ideology were
acceptable and which were not. Such transatlantic loyalty, as has been seen in
Chapter 2, was among the elements that made Moro push for the continuation of a
Bretton Woods type of embedded liberalism, in which Italy had to show a preference
for exchange rate stability as opposed to monetary freedom.

Moreover, the role of inflation on the public debt was far from straightforward, and this
had a certain impact in making things less evident, especially in a period of huge
expansion of state fund-raising which contributed to make the public debt - hence the
dependency on interest rates and inflation - grow by orders of magnitude.

5. CONCLUSIONS

From the evidence gathered on the main Italian pressure groups during the 1960s, it
has been possible to rebuild the ongoing debate regarding some economic variables
which were ultimately influenced by monetary policy, and in particular by the
international side of monetary policy as represented by the choice of the monetary
regime that might have replaced Bretton Woods after its possible breakdown or, as was
already clear since the mid-1960s, might at least have corrected the latter’s
malfunctioning.

As to trade unions, the evidence presented suggests that, indeed, a change took place
in the Italian trade unions’ positions towards international monetary policy. When one
looks at it through the three economic problems presented - the inverted relationship
between unemployment and inflation, the exchange rate regime, and the debate on free
trade - it is easy to observe some change in all three of them during the 1960s. Whether
some of these changes were actually consequences of the shift in views towards
European integration, or they were all to be listed among the causes of such shift, it is
not possible to say with certainty, as is always the case with the complex dynamics that
underpin the history of ideas. What it is possible to affirm is that, as the decade went
on, the Phillips curve was surely less and less worshipped as an essential economic
truth, as witnessed by the confusion of means and deeds that has been a constant of the
documents quoted in the previous sections. In terms of views on exchange rate systems,
if it is correct to hold that the initial anti-Bretton Woods idea of CGIL never translated

139 Centro Studi di Politica Economica del CC e del PCI, CESPE, Aspetti dell’attuale situazione economica internazionale, Bollettino no. 29, April 1969, pp. 21-25.
140 Democrazia Cristiana, Atti e documenti della Democrazia Cristiana 1961-64, Rome, 1964, pp. 708-713.
into an explicit rejection of the fixed rates system, one must also note that during the late 1960s the unions adopted the view that inflation was imported from abroad. Finally, the sectoral nature of interests in international trade proved difficult to tackle, with the consequence that the final trade unions' positions on trade became simply a function of the general autarchic positions that trade unionism tended to take during those years.

While the judgement against Bretton Woods was never in dispute, therefore, the change involved essentially the unions' position towards Europe, with a progressive softening of the initial suspicion towards the Werner Plan and, in general, the fear that Europe would just be a new form of imperialism - as witnessed by the repeated considerations regarding the EEC allegedly being favourable to large-scale business and market power.

Moving on to business associations, despite the differences in relative positions on each of the four analytical themes that have been chosen as the conceptual framework, it has been possible to isolate certain general tendencies common to the majority of them. Minority positions, such as the State-controlled industry's views on European integration, have also been taken into account in order to soften the possible conclusions regarding the ultimate influence of these ideas on policy-making. The peculiarity of the bargaining methods of Italian politics have also been considered.

One general conclusion that is to be drawn is that business associations developed an active debate, especially as regards certain aspects of policy-making, and this must certainly have played a very important role in influencing the choices at governmental and parliamentary level, a role further strengthened by the convergence of many policy views between business associations and trade union movement, mainly on the problem of inflation, which was a novelty in the economic picture of post-war Italy.

On its side, the financial system was bound to a politically-driven loyalty to Bretton Woods that did not actually stem from economic analysis. The latter would have indeed suggested to respond to the internationally irresponsible behaviour of the American ally by detaching from the US-centred monetary system and switch to the European fixed exchange rates, even if this preference would not stem from the fixity of rates themselves, but from the price stabilization that would be a corollary to the European project.

The overall positive consequences that the views developed by all these actors had in terms of welcoming a potential shift towards a European-based monetary system would end up having the most importance during the early 1970s, when the collapse of Bretton Woods made it suddenly clear that solutions had to be found in this sense. The debates described, which took place during the 1960s, may be seen as preliminary to the development of such choices. The claim that is made here is that such debates even contributed to determine Italy's final position on the issue of European monetary integration: indeed, despite not having a counterfactual scenario on which to test this claim, it is hardly possible to imagine that the Italian policy-makers would have been able to promote any aspect of European integration, and specifically the convergence of monetary policies implicit in the monetary cooperation projects, without convincing the trade union movement that such a development would have been beneficial to the working class on each and every problem that has been described in the present analysis; or without Confindustria's vested interest in developing a continent-wide liberalized market for Italian industrial products; or without the satisfaction of Confagricoltura and Coldiretti's requests during the negotiations following the presentation of the Mansholt Plan for the development of agriculture; nor, for that matter, would it ever have been conceivable for the government to promote international integration without solving the internal struggles relative to the State-controlled stakes in the debate around the liberalization of markets, or the problems of capital availability the country was experiencing as of the late 1960s.
CHAPTER 8

ITALY AFTER THE BREAKDOWN

When politics has to betray its own morality, to choose morality equals to betray politics.

-- Ugo La Malfa

I. INTRODUCTION

The description offered in the two previous chapters has provided an overview of the different actors involved in policy-making, and outlined the respective positions as well as the drivers that led to them. The aim of the present chapter is to put these views together in order to analyze how such a diverse background ended up determining the course of policy-making that the country eventually pursued in the wake of the phasing out of Bretton Woods. It is possible to look at the latter in terms of a specific event - namely President Nixon’s decision to interrupt the gold convertibility of the US dollar on 15 August 1971 - or as a process, spanning from the spring of 1971 with the flotation of the German and Dutch currencies, up to the final breakdown of all parities that took place in the spring of 1973. Whichever perspective is adopted, there is room to affirm, as will be pointed out, that the defining moment for Italy’s foreign economic policy was the immediate aftermath of Nixon’s decision of 15 August, and the Smithsonian Agreement of 18 December that may be seen as the official acknowledgement of the former decision: shortly after that, the Italian views on Bretton Woods and the European “monetary snake” were finally stabilized, and by the actual start date of the “snake” in the spring of 1972, the country’s policy debate accepted that there had been a permanent shift from one monetary order to the other. Even the trade unions and the Communist Party would accept the new arrangement as a permanent step of a broader historical process leading Italy into a European integration framework.
In the chapter on Italian policy-makers, the Colombo government was left between a rock and a hard place. On the one hand, Colombo and the other dorotei felt bound to the transatlantic link. Therefore, they did not look at international monetary events from the Gaullist perspective of trying to break the ties with an uncomfortable ally on the other side of the ocean. On the other hand, however, the internal politics of the Christian Democrats had never been adversarial. Hence the dorotei were constantly bound to look for the consent of all other correnti in order to find an agreed way forward. This applied to the choices regarding the monetary regime, too. In particular, the main opposition to the attempt at saving Bretton Woods as such came from the morotei, whose close ties with the Socialist Parties' views, whose participation in Jean Monnet's "Comité d'Action pour les Etats Unis d'Europe" and whose welcome to Willy Brandt's Ostpolitik were, in those times, the main source of trouble to the governmental line. In particular, genuine Europeanism was lacking among the dorotei ranks, with the notable exception of Giulio Andreotti whose support for European unity - although stemming from something close to the initial American support for a post-war order with a united Western Europe - was strong and made him look at the "monetary snake" as one desirable step in the process of creating ever stronger ties among EEC countries.

If such was the situation within the main party, the remainder of the governmental coalition could not be said to be in full agreement with it, especially as regards the domestic policies that were shaped differently as a consequence of the international situation: for instance, Ugo La Malfa protested against the soft line taken by the government towards the trade unionist movement, as if the causes of inflation had not been related to strikes and unionist pressures for the increase of nominal wages. Such disagreement on economic policy was quite far-reaching: as shall be pointed out, La Malfa would drag PRI out of the cabinet in early 1972, hence dooming the latter to resign, and the new government would be led by Giulio Andreotti, an eventuality that would have consequences on Italy's international economic policy choices, given the marked pro-Europe views of the new Prime Minister.

Despite the slightly different tones, both Socialist Parties looked at the European design favourably, a view that in the case of PSI was especially strong, a European monetary arrangement being perceived as an alternative to the American-centred system. The Communists of PCI, instead, remained opposed to the "snake" as they were in general sceptical of the entire EEC project, looked at as a further step of the capitalist domination over the Western world; a view also shared by the leftist trade union, CGIL, whose views changed during the 1960s to a more pragmatic acceptance of the EEC as a fact.

The other unions' views, instead, were less ideological and more linked to actual economic and strategic reasoning. On the one hand, inflation being the main economic theme of those years, and the unions being looked at from many sides as being responsible for the phenomenon, a new monetary system less dependent on certain countries - whose high inflation rates were being exported - would have been preferable to the current one. On the other hand, the translation of policy-making responsibilities from a national to European level might mean for the national unions a less strong leverage, especially considering that the evolution of the European trade union movement was not as advanced as that of the European institutions that would take responsibility for the making of a Europe-wide monetary policy.

The same view on the problems of giving up responsibility to Europe was shared by the central bank's governor, Guido Carli. In his case, however, such a position evolved well before the events of August 1971. In principle, as a doroteo, Carli was not particularly keen on accepting European integration more than an overarching transatlantic loyalty would have allowed. As a central banker, however, he was experiencing the difficulties of keeping monetary variables under control while attacked from both flanks of domestic and international inflationary pressures. As early as June 1970, he was already suggesting the widening of the 1 percent band within which the Bretton Woods currencies were allowed to fluctuate; a proposal that was later advanced by the United States itself, on 12 August 1971, to the IMF's Executive Committee, an action that was promptly reported by Italian newspapers as being linked to Carli's proposal.1 Wider floating margins, that would in fact have transformed the fixed exchange rates system into one of crawling pegs, were indeed seen as a possibility that would save Bretton Woods; incidentally, they would continue to be looked at as such

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1 Corriere della Sera, 13 August 1971, p.2.
even after 15 August: a 2.25 percent margin on both sides of parity would be introduced by the Smithsonian Agreement of 18 December.

The general picture was therefore rather complex. The governmental majority remained tied to the idea of saving Bretton Woods through a reform adopting wider margins, as had also been preached by the Bank of Italy’s governor until that point. This view was accompanied by a general disbelief in European integration, although an internal, strong minority within the Christian Democrats - the morotei plus Andreotti - remained strongly in favour of European monetary integration, either as a complement or a substitute of Bretton Woods, a view also shared by the two Socialist parties that made the governmental coalition.

In line with the “party-State” model, almost all other actors were attached to either of the two Christian Democrat views, despite often using different tones and stressing specific points rather than others: most business associations sympathised with the European view, due to the majority of the country’s external trade taking place with European partners; even the farmers’ association, Confagricoltura, that was sceptical of the Common Agricultural Policy, took European integration almost for granted in all other aspects of policy-making. The notable exception in the industry was the state-controlled business association, Intersind, that had a more moderate view of European integration due to the fear that Europe would push towards the erosion of the monopoly position upon which state-controlled industry based its prosperity. This view was closer to the right wing of the Christian Democratic party, that is, the traditional view of a part of the dorotei. Similarly but from a totally different perspective the main European sceptical view was expressed by PCI and its affiliated trade union, CGIL.

There seemed not to exist a real tradition of civil servants’ views, either within the central bank or within the economic ministries. In the case of the former, the extraordinarily long mandate granted to governors made the Bank of Italy’s position basically coincide with that of the governor in charge: and in particular, Guido Carli had already been in office for ten years by the time dealt with here. The latter were continuously reshaped, with the consequence that even if ministers turned over much more often than years in the calendar, ministerial functions did so too, with the consequence that no real institutional tradition was ever allowed to sediment. Again, then, the core of the policy-making debate may be said to have been revolving around the internal disputes among Christian Democrats.

2. THE ROAD TO 15 AUGUST 1971, AND ITS AFTERMATH

As was the case for all its European counterparts, the summer of 1971 was the time for the Italian government to put all opinions and pressures together so as to define a policy position on the international monetary system. Indeed, many elements seemed to suggest that important changes were imminent, and in the event of a fundamental shock taking place at the international level, of course, action would be required within each country of the system, including Italy, in order to take a place on the new equilibrium, or disequilibrium, that would follow. Specifically, the large American deficit that had built up over the previous years remained at the core of the monetary debate: as late as 7 August, “three important currencies float (the Deutschmark, the Dutch guilder and the Canadian dollar). As long as they continue to do so, they will cause the fluctuation of opinions. Worries and doubts are then generated by the recent news on the external deficit of a large country”, commented French president Valéry Giscard d’Estaing in an interview. Some leftists voices in Italy, as has been seen, even attributed such deficit to the US’s choice to wage the Vietnam War and then load the burden on the Europeans; one further reason to dislike the situation.

During July, as has been seen in the conclusion to Chapter 6, the positions of the most prominent policy-makers involved in the decision regarding the monetary regime - that is, Treasury Minister Ferrari-Aggradi and Governor Carli - gave a demonstration of political realism in affirming that it would be necessary to “restore as soon as possible fixed and realistic parities within the Community”, welcoming the idea of a European agreement within the worldwide system, but implicitly referring to the necessary precondition that the Deutschmark should be revalued. Such position placed these policy-makers along the lines of a realist Europeanism, in which the “monetary snake”

1 France Soir, 7 August 1971.
2 This was Senator Fabbrini’s position. Senato della Repubblica, Commissione Affari Esteri, 3°, Sedute delle Commissioni, 304, 24 June 1971, p. 36.
would just be a regional arrangement within a Bretton Woods transformed from a fixed rates system to a crawling peg, hence formally preserving transatlantic loyalty: on 10 July, Corriere della Sera reported that “the official visit to the United States by Colombo and Moro had the effect of convincing the Americans that the ECM does not constitute a war machine against the United States itself.”

However, the events of early August convinced more and more Europeans of the opposite: that the American economy was being used as an instrument of exploitation against European countries, and that the dollar capital moving around European markets should be turned back to the United States for immediate conversion into gold, as French commentator Alain Vernay had suggested on Le Figaro, in an article entitled “Healing from the Dollar” and replicating the famous claims once advanced by General De Gaulle, advised by Jacques Rueff. Even Confindustria, certainly not anti-American as a pressure group, in these months had asserted that “the remedies for European countries have to be sought within Europe. Ultimately, Europe must realize that, as was said, ‘in order to live with an elephant, you must at least be an elephant yourself’, meaning that only a European currency, sustained by an integrated economy comparable to that of the United States, would be able to escape the consequences of the American monetary events.”

In the working week from 9 to 13 August, the news began to spread as to the fact that the United States was suggesting a widening of the 1 percent fluctuation band, an event which undermined confidence in the American currency, which touched low records in all European markets, and required many central banks to sustain the Bretton Woods parity by buying dollars at rates higher than the corresponding markets.

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8 Corriere della Sera, 10 July 1971.
9 Alain Vernay, Le Figaro, 5 August 1971.
12 “Nuovi minimi per il dollaro”, Corriere della Sera, 13 August 1971, p. 3.

President Nixon’s announcement of his New Economic Policy was “broadcast live on radio and television” at 9:00pm on Sunday 15 August 1971. Even if the announcement did not come as a total surprise, especially to the people in the government and at the Bank of Italy, what certainly struck the attention was the breadth of the measures, ranging from the suspension of the gold convertibility of the U.S. dollar to a protectionist 10% import surcharge. Timing was also accurately chosen: in the evening of a mid-August weekend, most European parliaments were closed for vacation, many ministers and officials were on holiday, and on top of that, due to the time zone, it was already late night in Europe.

It goes without saying that Nixon’s expedient made all ministers rush home from vacation. It immediately became clear that Colombo’s cabinet, which had been in office for only twelve months thus far, was in a difficult position, as the national currency’s stability was at risk and, at the same time, a decision was to be made as regards the inevitable choice between trying to defend the existing exchange rate parity, or fluctuate and seek monetary stability through the EEC mechanism of the existing European Monetary Agreement and of the forthcoming “monetary snake” whose implementation would certainly be supported by those countries which, in the light of the events, would choose to try and form a “European bloc” floating together in the international money markets.
This choice proved to be especially delicate for a cabinet whose balance of power was already so fragile: thus far, Ferrari-Aggradi had remained in line with the orthodox doro1 view that America came first, therefore sustaining the already mentioned need for support to the Bretonn Woods system.25 Certainly, however, Colombo had a different take on the issue, relying more on a European solution to the crisis,26 and in this he was supported by Aldo Moro,24 who happened to be the Foreign Minister at that juncture. The Social Democrat and Finance Minister Luigi Preti was in line with Ferrari-Aggradi’s view, while his Socialist counterpart in the economic triad, Budget Minister Antonio Giolitti, thought it was time for Italy to take a definite step towards Europe,29 therefore subscribing to the Prime Minister’s line.

The bad news was that Colombo’s cabinet, which had been in charge for only twelve months thus far, had to make a quick decision on a subject upon which domestic disagreement was tangible. In such dire straits, the difference might have been made, as usual for the Italian political system, by the small forces, in this case especially by the Republican Party, which coincidentally held the most pragmatic view on foreign policy, due to its views oriented towards the immediate national interest: and in the wake of a potentially dreadful international monetary crisis, it was clear that the short-term national interest sought by a character like La Malfa would be a European solution rather than the Breton Woods standard, which was certainly - or at least this was the impression during those days26 - going to be put in difficulties by both the suspension of convertibility, as well as by the possible trade retaliations following the import surcharge.27 However, as La Malfa himself told Corriere della Sera on 20 August, “it [had] been asked to the Republicans to open a government crisis”, which implied that such crisis was near. Even so, La Malfa continued, “They replied they would not. But


this means that, after the election of the new Head of State, the Republicans will expect a review of the situation with the other forces of the centre-left coalition. And if the other parties will not listen to their suggestions, they will move to the opposition.29 A governmental party moving to the opposition, in a system in which all cabinets were able to survive on a handful of parliamentary votes, would mean of course to open a government crisis.29 And the interesting fact, which obviously the smart La Malfa was aware of, was that the election of the new Head of State was due in December of that year,30 that is to say, in a few months: just the time to have a look at the new international economic equilibriums and decide what claims the Republicans would have to present in order to keep the cabinet alive.

During the week following August 15th, the cabinet members and the representatives of their allies made an interesting variety of controversial declarations. On the very day after, August 16th, Treasury Minister Mario Ferrari-Aggradi met with Governor Carli and Prime Minister Colombo. They decided to pursue a European line, deferring any final decision to the EEC Finance Ministers meeting programmed for the coming Thursday, 19 August,31 in a few days, such European line would become more and more definite, with Italy seen as the promoter of a European solution to the crisis,23 as was also reported by all major European newspapers. On the same day, Ferrari-Aggradi declared that “the American decision requires a European initiative for an international monetary system based on conditions of parity.” He was a doro1eo, and in fact there was an element of Americanism, insofar as he called for a rescue of the world system by “a restructuring of the parities of industrial countries relative to the US dollar, and the widening of the fluctuation range of European currencies towards the dollar”, that is to say, exactly what would happen in a few months with the Smithsonian Agreement. But his focus was entirely on “the concrete acceleration of the process of monetary

29 Ugo La Malfa, “Perché abbiamo voluto la crisi”, Carte La Malfa, serie IV, envelope 221, 1972 governmental crisis.
30 Ugo La Malfa, L’altra Italia, Milano, 1975.
integration in Europe". Moreover, the European solutions were presented as a clear alternative to the Bretton Woods system, insofar as Ferrari-Aggradi called for a system "based on conditions of parity", meaning a system without the US dollar as the central currency. The reason was that, ostensibly, the US proved unable to manage its own balance of payments under the pressure of international capital movements; which may be true, but in principle, it was an explanation to which Nixon’s move of 15 August added nothing substantial in economic terms. Evidently, though, the suspension of convertibility proved to be the casus belli capable of triggering the reaction to what was actually a more long-term problem.

It is useful to explore to what extent there was a consensus on the contents of the declaration quoted earlier. Ferrari-Aggradi and the Prime Minister were quite on the same lines of thought: in preparation for the EEC Finance Ministers meeting set for 19 August, Corriere della Sera reported, Ferrari-Aggradi had a meeting with Colombo in which they outlined that the policy would be that "Above all, Italy wants to promote a unitary action, as wide as possible, so as to be able to involve on a common line not only the six countries that are part of the European Community, but also Great Britain, and so as to avoid unilateral initiatives that might have the taste of retaliations. A "common line", then, which should have been common to the European countries as well as to the important future new entrant, the United Kingdom. A line which, once again, implicitly put the European-based position in opposition to the simple restoration of Bretton Woods as it was before. Such implicit opposition made the Budget Minister, the PSI Giolitti, align with the same position as his other two DC colleagues. Even more, he defended the concept that unilateral action should be avoided, arguing that "Unilateral decisions [...] which are in contradiction with the rules of international monetary cooperation, and even have the features of a retaliation rather than of a remedy, such as the import surcharge imposed by the USA, are not viable solutions to the problem created by the United States’ balance of payments deficit." 35

34 Treasury Minister Ferrari-Aggradi would specify his position during an interview to Corriere della Sera the following day, Cesare Zappulli, “La lira e il dollaro - Intervista con il Ministro del Tesoro”, Corriere della Sera, 18 August 1971, p. 1.
35 Ibid.
36 Ibid.

3. GOVERNOR CARLI AND THE DOROTEI AT CROSSROADS

All in all, the greatest novelty of the day was that, with the approval of Governor Carli who flew to Brussels with Ferrari-Aggradi, the proposal of Italy was composed of two points:

1) a reform of the international monetary system, in which "the creation of liquidity must come mainly through instruments adopted in the most appropriate international institutions", that is to say, the International Monetary Fund and the institutions of the European Community;
2) acknowledgement of the other functions of the dollar, such as its role as currency of intervention in the exchange rates market and as currency used in international trade and financial transactions, "until the European economic and monetary union will have made enough progress" [...].

The idea of a "one world" fixed exchange rates system, therefore, had not totally been ruled out; however, the possibility that in the foreseeable future Europe might replace the system with a European-based solution started to come out as the official governmental position.

One might wonder how this position could have been consistent with the one promoted by the right wing of DC, as well as by the government and by Guido Carli, consisting in avoiding the obliteration of the Bretton Woods system. Had Europe not been seen as a complement rather than a substitute of such an American-based system? Apparently, contingency was making policy-makers shift towards the position which, as has been seen, had so far been promoted only by political actors much more to the left than the dorotei.

As a more economic explanation for this shift, in the Bank of Italy’s annual report for 1970 (which was written in the spring of the following year than the one it referred to), Guido Carli claimed that "The rise of domestic interest rates and the contemporary fall of the main rates abroad reinforced the efficacy of the initiatives taken by the

37 Ibid.
monetary authorities and have also had important direct effects, thereby contributing to the diminution of the export of Italian capitals.\footnote{Banca d'Italia, \textit{Relazione Annuale per il 1970}, p. 153.} The problem of capital outflows was very much of a current issue, as it could have dragged the balance of payments down at a time in which a current account surplus was already in place and, being the latter caused by lack of domestic demand as opposed to being the result of a strong export-led growth, it was really not necessary to push it any further in order to offset larger capital outflows. At the same time, however, in a fixed exchange rates system, the interest rate needed to be used in the way Carli just described, however costly, as a different use of this instrument would have put unwanted pressures on the exchange rate. All these reasons definitely started to contribute to put the entire Bretton Woods system in a very new light, in which the benefits of exchange rates stability had to be compared to the rising costs of having to gear monetary policy in order to offset the problems of the American dollar, as opposed to other issues of a domestic kind, which Italy was certainly not lacking at that stage.

This new balance would not change throughout the months leading to the Smithsonian realignment of December 1971, which was in fact one step back from the expectations of the delegate to the meeting, Treasury Minister Ferrari-Aggradi, as witnessed by the fact that Italy agreed to take part in the realignment only after having secured special conditions of fluctuation for the lira.\footnote{Francesca Fauti, \textit{L'Italia e l'integrazione economica europea}, Bologna: Mulino, 2001.} On 18 December, however, Prime Minister Colombo was enthusiastic about the fact that “The political significance of the accord [...] is that the largest industrialized countries are still willing to cooperate, in harmony of intentions, along the way towards expansion, in coherence with the principles of the freedom of international trade and of the fixed parity among currencies.”\footnote{Corriere della Sera, 19 December 1971, p. 1.} Probably, however, this was just what it was necessary to say at that stage, or at least so it seems from the generic terminology used. In fact, if one refers to the Bank’s annual report for 1971, published more than five months after the Smithsonian Agreement, one finds out that “As regards the basic problems of the international monetary order, the Washington accord did not go beyond the indication of general orientations regarding the broad lines of the negotiation.”\footnote{Banca d'Italia, \textit{Relazione Annuale per il 1971}, p. 12.}

In this picture, Carli had started to look at Werner’s European project as a way out of the exchange rate instability that would probably follow the demise of the existing monetary system, whose magnitude would be very difficult to predict at that early stage. This also explains why such newly acquired pro-Europe view, apparently shared by cabinet dorotei such as Ferrari-Aggradi and Colombo himself, was still seen as a complement to a Bretton Woods with amended floating margins: while in the original rules the 1 percent band produced a total 4 percent margin between each currency (from A touching the upper US dollar margin and B touching the bottom of its own parity range, until the exactly opposite situation), the Smithsonian 2.25 percent produced an effective peg with a 9 percent breadth; which is to say, a protection against a monetary crisis, but not an effective guarantee of stability do the daily business of foreign trade, in the light of which a 9 percent margin was way too large a foreign exchange risk.

4. OTHER GOVERNMENTAL SUPPORTERS: SOCIALISTS, REPUBLICANS, AND (SOMETIMES) THE TRADE UNIONS

As has been pointed out, Governor Carli’s views had until then gathered a common bloc with orthodox dorotei like Forlani and the old guard of DC; however, these views were openly criticized from a Socialist perspective: besides Budget Minister Giolitti, who was supportive of nothing short of a European solution,\footnote{F. Roy Willis, \textit{Italy Chooses Europe}, Oxford: Oxford University Press, 1971, p.292.} other voices were also raised within PSI in favour of taking this opportunity in order to disentangle from American hegemony, a view that was also shared by trade unions, notably not only the leftist CGIL\footnote{Parenthetically CGIL’s favourable position was rooted at least one decade earlier. \textit{Rassegna Sindacale}, July 31 1957, pp.420-421.} but also the Catholic oriented CISL.\footnote{F. Roy Willis, \textit{Italy Chooses Europe}, Oxford: Oxford University Press, 1971, p. 244.} The grounds, or the excuse, for the latter positions were economic rather than political: CISL leader Bruno Storti mentioned the need for a monetary solution in line with Italy’s natural pattern of continental
cooperation, while PSI leader Mancini called for the fostering of European cooperation on monetary issues, in a way that would have been totally unacceptable to the same party only two decades earlier, and which actually came as a novelty to some of the contemporary members of PSI, not all of whom were completely supportive of European integration.

Finally, coming to the Republican Party, it is particularly interesting to point out how, in a speech of November 1971, PRI leader Ugo La Malfa clearly saw the two issues of the American balance of payments and the process of European unification as largely interconnected, or, to be more precise, he claimed that these events should have been looked at as interconnected by politicians in the previous decade:

"While the United States was criticized everywhere in the Western world for the deficiencies in its balance of payments, a criticism indeed backed by evidence, it would have been necessary to be prepared for the consequences that a changed policy by the United States - suggested by that same criticism - would have produced. It would have been necessary to look forward, and speedily build a unitary alternative with a European character, instead of trying to build it afterwards, when the necessities or the contingent national selfishness would have had priority over the common interests."

Actually, La Malfa himself seemed to come to realize this problem after the fact: in his congressional speeches of 1965 and 1968 there was no trace of the development of a similar analysis; in the sections devoted to international politics, Europe was not even mentioned, and all the room was devoted to Cold War analysis, and used Cold War terminology (Communism, bipolarism and so forth) rather than EEC speech (common market, trade relations and so forth).

All parties in the quadriripartito were then favourable to the European way out, no later than three months after the event of 15 August. Looking at the scope of the shift in views that had to be made in order to reach such alignment on views regarding the international monetary regime, it seems that the greatest shift was made by Ferrari-Aggradì in the very days after 15 August; indeed, the Treasury Minister started from the idea that Breton Woods and its fixed parities had to be defended against the odds of savage fluctuation while, within one week, he had become the main supporter of the European solution represented by the parallel floating of European currencies. His position was also backed by Governor Carli, who later explained this change of views in terms of the fact that a common floating would protect Italy against sudden shifts in the current account variables better than would have been done by the uncertain defence of the Breton Woods parities.

The temporary satisfaction that the Smithsonian Agreement created in political circles belonging to the more Atlanticist positions would not last long: within a few months of the agreement, moderate DC Andreotti would orchestrate the entry of Italy into the "monetary snake", after which point it became clear that the main focus of international monetary policy had shifted. The long haul of the political realignment that followed made the other political actors review their own positions during the years to come: most notably, the trade unions, and later even the Communist Party, managed to soften their own views and became favourable to the European experience. Of course, one may not affirm that these broader shifts took place solely because of the monetary choices of 1971; and sometimes changes in policy views took place because of, or were triggered by, reasons of their own, as is the case of trade unions themselves, whose shift towards Europe was probably due to the better organization of the European trade unions movement, or to what was seen as an inevitable development, than to the economic advantages that the "monetary snake" would have represented for the working class; but certainly the new monetary choices played a role, at least in softening the ideological cleavage that had historically existed between DC and the left

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45 Ibid.
48 Ibid.
49 International speculation, caused by the uncertainty about the destiny of Breton Woods, had already determined a number of recent monetary crises, from Britain four years earlier, to Germany only four months back.
50 Luciano Lama, Intervista sul sindacato, Bari, 1976, pp. 77-78.
52 "[...] our position, as CGIL, has always been that of recognizing the objective nature of the processes of economic integration in Europe." UIL Archive, V Congresso Confederale, Saluto di Agostino Novella Segretario Generale della CGIL, 27 October 1969.
on the issue of Atlanticism, or of the dose of it that was acceptable to the Italian political system.53

These changes of views were going to produce a general shift within DC itself. Even certain moderate areas of the party became supportive of the European project: it was a cabinet led by the right wing Giulio Andreotti which, in the spring of the following year, would have worked out the entry of Italy into the “monetary snake”, negotiating a particularly favourable package including a temporarily wider fluctuation range.

Apart from the people more or less belonging to the Christian Democrats’ area, other shifts could be noted in the other parties’ views. The two Socialist parties took similar positions in the weeks after the breakdown. In charge of explaining the solution proposed by PSI at a meeting of the Socialist International, Nerio Nesi would affirm that

“First of all, it is necessary to strive for a unitary action of the Europe of the ‘Six’ on the basis of the project presented by Benelux, appropriately corrected. The same way, another step could be taken in the direction of the creation of a European ‘pool’ in which each country would place its own dollar reserves, in order to use them as reserves in front of the rest of the world.”54

Nesi was referring to the Werner Plan: clearly Bretton Woods, with its centre on the US dollar, was no longer seen as a viable option, since “As regards the rearrangement of the international monetary system, the Credit Commission of the Italian Socialist Party pointed out that, in the future, it will be necessary to avoid the situation that reserve currencies (as has been the US dollar so far) be at the same time national currencies too.”55

The Social Democrats’ Party PSDI took a very similar position, at least as regards Europe. As early as 1965 its main representatives, among whom Mario Tanassi and

53 Sergio Romano, Guida alla politica estera italiana, Milano: Rizzoli, 1993.
54 The original version of this note is in French. Fondazione Turati, Fondo PSI, Direzione Nazionale, Dipartimento Internazionale, ss. C, b. 26, 14 October 1971.
55 Ibid.

5. THE COMMUNIST OPPOSITION

Even if similarly unhappy with the United States’ policies, the Communist Party nevertheless adopted a very different position. As clearly expressed by PCI’s official newspaper L’Unità, the Communists still saw Europe as a threat rather than an opportunity, regardless of the claims made by Prime Minister Colombo regarding the fact that Europe had fostered better relations with the Eastern European countries which, after all, were Soviet satellites. As of early 1977, PCI secretary Enrico Berlinguer thought that “[...] the main problem in Italy is that of an effective public direction of the economy through democratic planning. [...] the democratic State must be able to consciously manage all public investments, and control those of the largest private groups.”56 Economic planning remained therefore the main idea of PCI. Economic planning, it has been noted, was adopted in Italy, with five-year plans, since the advent of the centre-leftist phase in Italian politics at the beginning of the 1960s. This was the type of economic planning Berlinguer was referring to. However, it must be noted that such planning required the state to keep all the economy under its own control - a theme also dear to CGIL, as will be pointed out later in this chapter. In 1972, Berlinguer himself addressed the apparent contradiction between affirming national sovereignty and being in favour of internationalism, clarifying that PCI intended “to bring Italy outside the subordination to a foreign imperialism [...] in order to give Italy the role of a great and free Western nation, committed to a project with a European and global perspective.”57

Given this attitude, European monetary integration was then discussed in very careful terms. Eugenio Peggio, the editorialist of “L’Unità” on August 17, 1971, that is, the Monday after Nixon’s decision to close the gold window, expressed a view of the problem that is coherent with what has been analyzed so far, that is to say, neither Bretton Woods nor the European Werner Plan would be the ideal solution according to

57 Ibid.
Communist ideology. According to him, it was “necessary to beware of certain suggestions advanced by the Italian government. Indeed, it must be clearly affirmed that the grave questions that are at stake [...] cannot be solved in the restricted field of the cooperation among the six countries of the European Community [...]”.  

However, the ideas expressed by Peggio did not outline a clear plan as to how the new international monetary system should work, besides suggesting “the creation of a monetary system founded on a conventional currency that would effectively be every country’s currency, [since] the dollar, in its fluctuating form, can no longer be used as the international reserve currency”, 59 which is more a denial of support to both Bretton Woods and European monetary integration, rather than the proposal of a feasible alternative. Moreover, Peggio immediately expressed hostility towards the idea of a dollar depreciation, as it would be unclear “by how much the dollar might depreciate against the lira” while the only certainty, to him, would be “that the difficulties of certain sectors of our industry - shoemaking, clothing, ceramics, etc. - will rise substantially.” 60 This, of course, anticipated the Communist opposition’s view of the Smithsonian Agreement, which would represent the dollar devaluation referred to in this quote.

One may wonder what these “difficulties” would have been in practice; indeed, the preservation of relative exchange rate stability within the EEC provided Italy with a shield against exchange rate risk that would cover about three quarters of the country’s foreign trade. The Communist position might therefore be seen as a politically rather than economically grounded battle, whose roots dated back to the way PCI acted (and was perceived) within the framework of post-war Italian politics. This distinction in terms of causes of the Communist position might look pointless, were it not for the fact that it leads to the conclusion that PCI’s views would only change in the light of political, not economic, change. This explains why the party remained opposed to European integration even in the wake of the breakdown of Bretton Woods, and why it changed its official position on this specific issue later on in the 1970s, that is to say, when the political situation shifted PCI closer to the government, in a sort of recognition that a process of détente was taking place within Italian domestic politics.

### 6. THE DOMESTIC AND INTERNATIONAL DETERMINANTS OF THE TRADE UNIONS’ POSITIONS

While most times trade unionism and PCI went hand by hand in developing policy views - even if it was never possible to equate the two groups, due to the obvious non-Communist presence within the trade union movement - in the case of the events following the demise of Bretton Woods, two distinct patterns of action were visible. Evidence shows that many political and ideological views started to take a different course as soon as what had long been feared became reality in terms of international monetary policy, and this was the case with Italian trade unionism, too.

In particular, trade unions were naturally interested in the practical, immediate outcomes of monetary choices for their own members, which made them look at the monetary scenario with more pragmatic eyes; and it was in these very months that a large debate on the unification of the three main trade unions was taking place, hence creating a strong driver towards the development of common - and therefore pragmatic - views as regards all policy areas. On 10 November 1971, the internal magazine of UIL, “Il Lavoro Italiano”, published a joint declaration by the three confederations regarding the general conduct of Italy’s economic policy. From suspicion and hostility towards capitalist Europe, the new take, as well as the new economic reasoning, included a commitment

“to follow with special attention the initiatives and the solutions that are being proposed, especially in order to avoid adjustments which might produce effects of further stagnation of the Italian economic development. CGIL, CISL and UIL think it is necessary to search for a European solution to the crisis, based on a fixed exchange rates system. Such solution will be able to raise substantially the contractual power of the European economies relative to the US economy. The Italian trade unions think they must play an essential role of support and promotion of a political Europe, towards whose democratic institutions the role of workers and trade unions may have a significant leverage. In this sense, CGIL, CISL and UIL commit themselves to play a concerted action at the international level among trade unions, in order to create their international dimension, and in order to reach, in the

58 Eugenio Peggio, editorial of L’Unità, 17 August 1971.
59 Ibid.
60 Ibid.
present situation, a position regarding especially the speculative conduct of multinational companies, capital movements and the shortage of means of payments at a world level.63

By any standard, the tone towards Europe in this declaration was strikingly different from all that had come from the Italian trade unions thus far. The support for a European fixed exchange rates system was in contrast with the previous comments expressed on the Werner Plan, which is to say, the EEC-centred project that promoted exactly this view. Moreover, the claim that the trade unions “must play an essential role of support and promotion of a political Europe” deserves attention. Thus far, trade unions had not been enthusiastic about this project, due to the fear that their power would be reduced by a supranational entity with no ears for domestic pressure groups. Why then change position, and especially, why do so in the wake of the breakdown of one of the monetary “enemies”, Bretton Woods?

A hint towards the answer might be found in an article published two years later from the same UIL magazine. After the oil crisis, the author analyzed the long-term ideological problems of the concept of Europe, by juxtaposing Western Europe and the United States in terms of the latter’s belief in “a wrong equation: more production = more consumption = more income = more social justice.” Then, he suggested that the European choice should be more pragmatic: “What is going on, rather than a bad situation, might be the beginning, the starting point of a debate able to bring Europe’s unity forward. What is needed is political will, a political will not subordinated to ‘principles’ or foreign interests.”64 This reasoning applies to the monetary choices dealt with here. Ideology aside, Europe became a potential solution to monetary problems, for strategic reasons, as soon as the US itself showed to be no longer able to provide stability to the monetary system.

65 UIL Archive, Lavoro Italiano, year 2, 31 December 1973, p. 11.

7. FROM THE SMITHSONIAN TO THE "MONETARY SNAKE": THE FIRST ANDREOTTI CABINET

The outcome of the monetary events of 1971 was the Smithsonian Agreement reached in Washington on 18 December, which basically restored parities for all currencies with an average devaluation of 10% against the US dollar, and can be seen as the natural outcome of the American search for a downward adjustment on the value of its own currency. The Italian political debate at that stage was also, in a sense, the natural outcome of the domestic situation described in the sections above: in the wake of the Smithsonian Agreement, the situation described at the beginning of this chapter and developed until the election of the Head of State in November, drove the government into crisis. Emilio Colombo’s attempt at keeping domestic variables under control by expanding the economy throughout 1970 and 1971 had the effect that was later summarized by Governor Carli in the central bank’s annual report for 1971, in which he affirmed that “an income redistribution beneficial to salaries may create, in the short run, a rise in global demand; in the subsequent periods, however, there will be a slow-down deriving from the fall of investment, as a consequence of the previous fall in profit margins”.65

This was also, roughly, the reason why Ugo La Malfa’s PRI decided to withdraw external support to the government in late January; more precisely, La Malfa observed that the slow-down of production that took place in 1971 had been especially detrimental to the working class, as “when the national income falls, the same does the possibility of workers, and especially of young people, to find jobs with an adequate pay”66 and that such slow-down was attributable to the government’s misuse of resources.

At this stage, a tough choice was to be made by the Christian Democrats: what would the new governmental coalition look like? The choice was eventually to form a coalition in the configuration of the 1950s, that is, with PLI instead of PSI,67 the leader of this newly formed cabinet was Giulio Andreotti, whose right-wing orientation was clear, but

65 Ugo La Malfa, Gente, year XVI, n. 4, 23 January 1972, p.2.
whose political wit and potential for unexpected change had yet to be understood. In particular, Andreotti’s views on the best solution to the international monetary crisis were clearly far from what the traditional transatlantic loyalty suggested: only several weeks into the cabinet, he made Italy join the European “monetary snake”.

Actually, already during the Smithsonian negotiations, DC’s position was keeping an eye on the EEC. In this perspective, part of the DC support for the Werner Plan came from the fact that Pierre Werner himself was a Christian Democrat. In the words of a declaration issued on 15 December 1971 by the DC members of the European Parliament, after a meeting with DC Secretary Arnaldo Forlani in Rome,

“The developments of the economic unification, already oriented by the proposals of the Christian Democrat Werner towards an organic multi-year plan, encountered both the notorious monetary difficulties and the beginning of an unfavourable economic situation. The DC members of the [European] Parliament think that every effort must be taken in order to normalize the monetary, trade and political problems that have been raised by the decisions of the American government, and share the action of the [IMF] Executive Commission which is meant to restore by the current year a system of defined parities among the member states and to promote a coordinated action in support of the weakest regions and sectors, which are most exposed to the difficulties of the economic situation.”

Governor Carli was also to change his view on European integration; in the annual report for 1971 (written in March 1972), he admitted that “Given the fact that integration, when it touches vital nerves, is acceptable only when it takes place under conditions of parity, the organization of large economic areas able to compete with the economies of the largest world powers is a condition that must be satisfied.” As was clear, the dollar-centred Bretton Woods system was not symmetrical; this is why, Carli implied, it did not succeed in promoting integration. In contrast with this system, he went on, “The programmes for the monetary unification of the enlarged European Economic Community are based on this perspective.”

In the same annual report, several positions had not yet been consolidated: the evaluation of the Smithsonian Agreement of December 1971 was still positive, while it would become much different in one year’s time, when it would eventually give way to the free, unregulated floating of all currencies (except those of Europe’s “monetary snake”). Moreover, a currency union throughout Europe was not yet judged feasible by Carli, due to these countries’ demonstration of weakness when “they reacted to the dramatic events of 1971 as separate entities.” A marked change was detectable, however, from the earlier defences of Bretton Woods made by all the most right-wing, and pro-American, Christian Democrats, including the Governor.

This made policy-makers align to the new European line. Of course, however, opponents still existed, especially outside the government. But Communist opposition on this issue, besides being taken for granted, could not seriously influence the governmental line. The only real problem with Communist-led criticism came from the trade unionist arena, due to the latter’s leverage gained on the streets during and after the “hot autumn”. However, a further position in terms of monetary policy was to change during these months in the trade union movement, too, perhaps more as a consequence of the events of 1969 rather than of the collapse of the monetary system. However, this change too had an impact on the trade unions’ monetary views. As of 1972, discussing the economic planning for the years 1971-1975, the economic analysts of CGIL shifted the accent from the problems of international money to considerations of a domestic kind, such as that “The full control of monetary policy means that the two domestic actors responsible for the formation of monetary base, the Bank of Italy and the Ministry of the Treasury, must not be able to set the conditions of equilibrium between real and monetary streams by applying, every time there are tensions on prices, demand-reducing interventions. Instead, monetary policy must be able to understand the potential capacity of expansion of the economy, and promote the creation of monetary means that should be adequate to the full employment of resources.”

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67 Istituto Sturzo, Fondo DC, Segreteria Politica, Atti dei Segretari, Box 221, 1971.
69 Ibid.
70 Ibid.
71 Banca d’Italia, Relazione Annuale per il 1971, p. 19.
The economic analysis within UIL, starting from another side, reached the same point: in defending the trade unions' movement against the claims of politicians like La Malfa that the trade unions had large responsibilities in favouring the conditions for an economic crisis, Franco Simoncini of UIL made clear that the problem was not international competitiveness, as Italy's productivity was still in a leading position among the countries of Europe.73

This return to the preponderance of domestic factors had, of course, the effect of loosening the ideological opposition to European integration. In an interview of 1976, Luciano Lama commented on the early years of the decade and CGIL's position towards the European common market, affirming that there had certainly been a huge change, and implicitly confirming the impression that the shift took place because of strategy rather than ideology. In particular, he pointed out that "from an approach of substantial opposition, [CGIL] slowly moved towards the line of the internal criticism and of the transformation of the economic Community in a true democratic Community, in which workers must have an ever growing leverage. But this took place much earlier than our entry into CES [the European federation of trade unions] and in connection with a deep analysis of our economic and social situation which made us refuse more and more definitely any tendency towards isolationism or autarchy."74

In terms of ideology, it is interesting to note how Lama, perhaps not consciously, betrayed Stalin's "Socialism in a single country" and went back to the traditional internationalism that had been a permanent feature of the Italian Socialism: "If we want to transform our societies, economically different, with the method of democracy, the pressure of the masses as well as their direct participation to such transformation are fundamental instruments not only within each single country, but also on an international scale."75

As a consequence of these later, mid-1970s reflections on the previous years, it is possible to argue that CGIL reviewed its own positions in terms of monetary policy by shifting its focus from the consequences of international conditions on Italy's development to the role of domestic institutions in shaping such development. This observation must be coupled with the more open views towards Europe expressed in 1973, during the same congress, by Feliciano Rossitto who, referring to the negotiation of international trade agreements, while observing that the international community was "in search of a new economic equilibrium for the long run", also expressed the view that "America wants European borders open for its own agricultural products while threatening, in order to achieve this goal, to close its own borders to the import of industrial goods coming from the Community".76 This is an implicit acknowledgement that the EEC had become the subject of reference for this type of international negotiations. All in all, it can be argued that the trade unions' positions shifted towards the acceptance of European integration, witnessed by the absence of bitter references to the monetary snake in the 1973 declarations by Luciano Lama. Probably the events of late 1971, and the acknowledgement that a solution had to be sought at that stage - an element already present even before August 1971 - made the unions' position take a different shape.

Finally, one might wonder how industry and finance looked at this new change. Confindustria and the other associations of private business remained favourable to European integration, especially once the collapse of Bretton Woods paved the way to the uncertain period of multiple devaluations, revaluations, floating, which was certainly not welcome by anyone with an interest in foreign trade.

Confindustria's comment on the Smithsonian Agreement was that "the recent accords did not bring to the creation of the new international monetary system that everyone was invoking, nor to a new monetary arrangement promising stability", and

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73 Our adversaries tried to build a bridge of logic and coherence between the two banks of this deep contradiction, attributing every fault to trade unions behaviour and to their consequences: absence, permanent conflict, fall of labour productivity [even if in the period 1966-70 Italy is the first country within EEC, with an average annual increase of 6.3%, against the 5.2% of France and the 4.6% of the German Federal Republic, not to mention England, where between 1968 and 1969 the increase fell from 7% to 2.2%, remaining around that value also in 1979]. UIL Archive, "Il Lavoro Italiano", year 14th, no. 4-5, 10 February 1972, p. 14.

74 Luciano Lama, Intervista sul sindacato, Bari, 1976, pp. 77-78.

75 Ibid.

therefore Europe should take decisions on its own, as these “difficult years [...] might be enlightened by the emergence of a true European economic union, with a currency of its own”\(^7\) For its part, Confagricoltura was furious against the American call for more open trade arrangements for American products to enter European countries - and therefore against the underlying principle that triggered the August measures - as this was clearly against its members’ vested interests, with arguments along the lines of “the EEC imports ten times more butter than the United States, the latter applying at the same time a quota system”,\(^8\) and the solution was seen as Europe-wide rather than national.

The only exception was the organization of state-controlled companies, Intersind, whose stake was slightly different; even if these companies behaved the same way as private entities when it came to trade with abroad, it must be mentioned that the market power they enjoyed was constantly at risk of being eroded by any transfer of powers towards the EEC, whose common market objective included the expansion of competition practices which might limit the monopoly position of the state-controlled industry.

As a confirmation that these fears were grounded it must be pointed out that this was exactly the case from the 1990s; but the EEC of the 1970s was still far from being effective in this sense.

As the final chapter points out, there seems to be room to draw some conclusions regarding the hypothesis that a strong connection existed between the breakdown of Bretton Woods and the growth in importance of European integration, particularly on its monetary side, among the highest priorities of Italian monetary institutions. Indeed, from the initial positions of 1969, until the new ideas and views that could be recorded from late 1971 onwards, a very tangible difference clearly existed. What appears crystal clear is that the European integration, that followed, seems to have taken place at least in part as a consequence of that unilateral decision, which President Nixon decided to take during a mid-summer weekend of 1971.

\(^7\) L’Organizzazione industriale, 11 January 1972, p. 3.

\(^8\) Mondo Agricolo, 26 December 1971, p. 3.

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CHAPTER 9

CONCLUSION

1. CRISIS AND RESPONSES

The reader will recall Paul McCracken’s observation, in his 1977 report, that the history of the collapsing Bretton Woods looked rather similar to all other crises that took place in the same period, in its resulting from a mixture of unfortunate international circumstances and wrongly restrictive national responses.\(^1\) Regardless of the position one is inclined to take as to the reversibility of these events through the use of Keynesian solutions, what is sure is that most of the economic troubles in that decade were triggered by the lack of understanding, on the policy-makers’ side, of the exact causes of the situation they found themselves in.\(^2\)

To be fair, lack of economic awareness is a problem most historical periods have suffered from;\(^3\) nor are the 1970s the most striking example of it, if one looks at history in a broader perspective. At any rate, the collapse of Bretton Woods followed this pattern, both in America and in the European countries that have been the subject of the present study. Policy-makers and other actors focused on contingency planning, sometimes even making an effort to look beyond immediate political advantage, and trying to choose among the possible theoretical ideas that were suggested during those years. Many times, however, they came out with solutions that did not match the expectations, sometimes working in the short run, but then inevitably starting to falter.

It is in this picture that the present study advances the hypothesis that the common timing of the monetary events of 1971-1972, which led a number of European countries


to shift their monetary arrangements from the Bretton Woods worldwide fixed exchange rates regime to the regional solution offered by Pierre Werner’s “monetary snake”, were not only a matter of coincidence; rather, the short-term attitude of policy-makers created a causal link between the former and the latter. This hypothesis, as said at the beginning, would be verified in case most actors, involved directly or indirectly in the policy-making process, showed to consider the two choices as linked, in particular shifting their focus from the former to the latter system in the time framework considered.

2. THE UNITED KINGDOM

As Chapter 5 outlined in detail, between 1971 and early 1972 a policy shift drove the British pound from being the second reserve currency within the Bretton Woods system, as well as the centre of a sub-system - the Sterling Area - centred on the Commonwealth, to a completely new and unexplored situation in which a country with evidently resized international expectations had not only resigned from its Sterling Area role, but had also contributed to plant the seeds of the collapse of Bretton Woods, at the same time hedging its currency against uncertainty by taking part in the process of European monetary integration that had begun with Werner’s “monetary snake”. The core of such a policy shift took place in the months that elapsed from the opening of the crisis - Nixon’s announcement of 15 August 1971 - to 1 May 1972, when the British pound was linked to the other European currencies under the “monetary snake” fluctuation band of ±0.75% within the “tunnel” of the ±2.25% Bretton Woods as amended by the Smithsonian Agreement in December 1971. The interplay of the domestic actors directly and indirectly involved in policy-making during that period showed the rise of a mainstream view that represented a middle ground between the different policy interests of the governmental party, of a considerable part of the opposition, of the two main institutions in charge of making policies on behalf of the government - the Bank of England - and Whitehall, - and finally of the private interests of pressure groups such as the CBI and the City of London. Moreover, among the lower key determinants, one must not underestimate the facilitating role that was played by the fact that for about a half of this period - that is, between August and December 1971 - it looked as if the trade union movement’s interest coincided with that of the mainstream group in the attempt at saving the existing monetary system. As soon as it realized that the Smithsonian Agreement was seen as nothing else than a temporary cover for the shift of a number of European countries towards European monetary integration, the TUC detached itself from the mainstream positions and made an effort to criticize this choice, but this came rather late in the process and, despite the huge leverage enjoyed by this pressure group, it did not prove strong enough to change the course of policy.

All in all, it is in this short time framework that one has to look for the core of the shift in monetary views, that led British policy-makers to try the European experiment whilst abandoning Bretton Woods, as well as the monetary side of the traditional Commonwealth system of preferential relations. Against other possible time categorizations which do not describe this period as central in determining the UK’s international monetary policy shift - either explicitly by identifying different “days that made history”, or implicitly by not paying enough attention to the events which have been presented here as the main highlights of such shift - several observations can be made.

The first is that the mainstream view of British contemporary history, which at the moment seems to be centred on the two main domestic monetary events of these decades - the devaluations of 1967 and 1972 - adopts a distorted perspective in dwelling too much on the domestic determinants of the country’s international choices,

9 Letter from John Whitehorn, CBI to Alec Neale, Treasury, TNA T312/2841, n.50, 23 September 1971.
10 George Bolton to Edward Heath, TNA PREM 15/310, 8 September 1971.
while not taking sufficiently into consideration the external elements which played important, if not paramount, roles in the process. It would be a gross oversimplification, for example, to assume that the Smithsonian Agreement was simply an adjustment of a piecemeal nature to a monetary system whose continuity was allegedly not broken: on the contrary, as has been shown here, the idea that the US was forcing the rest of the world to accept a 10% devaluation of its own currency contributed greatly to the impression that the world’s monetary system was on the verge of a major change, at least in that it was so evident that diplomatic power was being exerted while the strongest actor on stage was unilaterally forcing choices within a system which, on the contrary, had been conceived in order to facilitate a cooperative management of monetary relations. When force is used on the international stage, no country can avoid the domestic reflections of this behaviour. Specifically, the UK experienced a reverse revaluation of around 10% of sterling against the US dollar due to the import surcharge, while the Smithsonian Agreement transferred its origin in the exchange rate itself when the surcharge was called off. The prospective reflection of the cheaper dollar on the British current account - that is, a downward slope - put even more pressure on British policy-makers in searching for new trade partners, so as to hedge against the potential worsening of the situation.\(^{15}\)

The second point that needs be outlined is that between 1967 and 1972 many elements in the monetary policy framework changed, and none of them was actually due to the effects of the two devaluations: neither the SDR scheme nor the gold pool were conceived as direct consequences of the British 1967 devaluation;\(^{16}\) Nixon’s ascent to power, his “benign neglect”, the subsequent worsening of the US balance of payments, and his final decision to break the link between gold and the dollar, were clearly more related to the American management of the economy than to any British economic variable; the Conservative electoral victory of 1970 was not driven by positions on monetary policy, nor did either the Wilson or the Heath government’s attempts at reorganizing industrial relations start because of monetary issues. The two devaluations, as is also confirmed by their being unanimously considered actions of last resort by both the policy-makers of the time and the existing literature on those years, were consequences rather than causes of the monetary policy choices that were made either domestically or internationally.

Finally, evidence shows that it is between the summer of 1971 and the spring of 1972 that the strategic thinking on a possible shift towards a European monetary bloc was concentrated, which makes it logical to suppose that the events taking place within that time framework were those that actually made Britain’s different institutions and groups position themselves along new policy lines: and from a British perspective, these events were basically the staged collapse of Bretton Woods, from 15 August through the Smithsonian Agreement, and the final decision to undertake the European experience by setting a timetable for acquiring membership on 1 January 1973 and the earlier entry into the “monetary snake”. The British entry into the “snake” was not easy, but it represented the first concrete act of cooperation between British policy-makers and the EEC, and the tones used by the British Treasury in order to justify the floating episode that followed 23 June 1972 bear witness to a completely new attitude.\(^{17}\)

3. ITALY

Perhaps the most striking evidence, outlined in Chapter 8, as regards Italy’s behaviour has been that it is possible to draw an almost perfect correlation between any position before Nixon’s unilateral policy choice of August 1971 and one specific, amended position after that event. The views on this issue can be split into several groups.

The first group is that of the right-wing of DC, which was leading the country at that stage. The traditional positions of the doriaei on the United States,\(^{18}\) and the paradigmatic choice of “embedded liberalism”, including the Bretton Woods international institutions, had been defined in the early post-war years and had not


\(^{16}\) See for example the TUC positions on the SDR as opposed to the other forms of monetary cooperation: “Economic Policy and Prospects”, TUC Economic Committee 10/6, TUC Archive, MSS/292D/409/2, 12 July 1972.


changed: Giulio Andreotti's statement about the traditional stability of Italy's foreign policy orientation is absolutely correct in this sense. A similar claim could be made as regards Europeanism, too: given the recognition of a certain advantage in having chosen to be part of the EEC since its inception, a decision mainly driven by trade reasons, the DC of the dorotei applied such view throughout the following decades. The fact that it had no ideological grounds or empathy whatsoever left the margins that were needed in order not to consider Europe in opposition to the United States. After all, the Americans had promoted the idea of the United States of Europe long before Monnet and Schuman did.

When dealing with monetary issues, however, the leadership of the dorotei never considered European monetary cooperation as a substitute for Bretton Woods. The formation of this idea took place at different levels. On the side of party politics, DC's leadership openly opposed any idea of Europe that might prove a counterweight to US hegemony: Forlani and Bernassola's quarrel with other DC people over the support to De Gaulle's own ideas of Europe is quite telling. At the same time, the cabinet showed a reluctance to consider the negative impact of the inflation exported from the United States, to the point that a wide debate was in place as to whether such imported inflation existed at all; at the time of Colombo's inauguration in mid-1970, while devoting some lines to the explanation of the necessary parallelism of economic and monetary progress within Europe, the American responsibilities were not mentioned in relation to Italy's monetary position.

On the side of the central bank, Governor Carli believed in the fact that inflation was being driven by the higher costs stemming from negative economic events - budget expansion and strikes - during the second half of the 1960s, and pointed this out in relation to the problems of the national currency, rather than claiming that an international import of inflation might have been in place. Carli was a Christian Democrat too and he believed in the transatlantic link as well as in the necessity to oppose De Gaulle's claims. Regarding Europe, he was simply a central banker, and every step towards European monetary integration would also have been a step towards a less significant role of national central banks.

All these positions, gathering under the Christian Democrat umbrella, were to change on the same lines after 15 August 1971. As has been seen, the government's reaction to the breakdown was to immediately advance the proposal for a European solution. Interestingly, such position was brought forward in a way that made it clear that DC's views, probably also softened by the experience of the centre-left cabinets that had been in office for all the previous decade, were shifting towards considering a European alternative to Bretton Woods rather than a simple cooperation under the aegis of a new IMF-based fixed exchange rates system. Governor Carli himself, despite not abandoning his own pursuit of an economic growth goal as well as his own decision to keep an expansionary monetary policy throughout the period, in the end modified his own views regarding the monetary regime: he agreed with the government's positions that were presented a few days after August 15th at the European ministerial meeting, and then inserted in the annual report of May 1972 a very clear passage saying that "conditions of parity" were now required in order to rebuild the monetary system. All in all, this was a slow but decisive shift towards considering Europe as the main port of call for monetary issues, a practice which would then be consolidated, with ups and downs, throughout the 1970s with the monetary snake, in the 1980s with the EMS and finally during the 1990s with the EMU project leading to the introduction of the euro.

The positions of the coalition parties were to change too, although to a lesser extent: as has been outlined, the internationalism leading to the Socialists' Europeanism was already a well established tradition and was not to change, if not to be reaffirmed, in the period after the breakdown of Bretton Woods. The opposite may be said as regards the Communist Party: a suspicion towards the unity of Europe was perceived during

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24 Ibid., p. 18.
Breton Woods, and was similarly perceived afterwards, as witnessed by Enrico Berlinguer’s declarations during the 1972 Congress of PCI.27

One group of actors that started from sceptical positions, so to say closer to the Communists’ views, and then moved on after the breakdown to consider the positive opportunities represented by European integration, perhaps in a more Socialist attitude, were the trade unions. By focussing more on the domestic institutions in shaping the country’s development (or the latter’s failure), the trade unions after 1971 mitigated their negative attitudes towards Europe.28 On the one hand it was the only possibility of exchange rate stability, and workers knew stable prices meant more to those who received a salary than to those whose job was to sell goods. On the other hand, the pro-Europe argument started to be seen as one element of rapprochement towards the government, after a period of very bitter social tensions.

Small extremist voices apart, it may be affirmed that by 1972 no Italian politician belonging to parties that shared governmental responsibilities during the experience of the quadripartito supported an American-based monetary system against the European project of monetary unification. Moreover, a generalized positive view towards such unification was shared by the entire group, with the only exclusion of the secessionists of PSIUP, and making a special mention to Ugo La Malfa who continued to see international politics as a function of domestic politics (a view curiously shared by trade unionists whom he never particularly liked29), and whose pro-European views were the consequence of economic considerations rather than a grand vision, this fact becoming of particular relevance when one looks at the way he opened a governmental crisis in January 1972.30

The post-war economic catch-up came to be in trouble during the 1960s, and it may be argued that the final picture, which reaffirmed the new European orientation of Italy’s monetary policy, stemmed from the realistic recognition that such catch-up was no longer in place. The social tensions of the late years of the decade, the emergence of inflation (be it created domestically or imported from the United States) coupled with unemployment, the relative loss of competitiveness of the Italian industry and, of course, the higher ties with the EEC represented by the introduction of common policies oriented towards the regional redistribution of wealth and the defence of certain categories of goods from external competition, were all making it clear that Italy was entering a new phase. This translated into the feeling that the previously undoubted, strict ties to Atlanticism and Europeanism as the recipe for fast development could be loosened: hence the formation of more leftist views within DC itself, not only with the leftist views of Dossetti and Moro, but also with the European accent that would later be adopted by right-wing people like Colombo and Andreotti.31 The same process was at the basis of the ideological shift which led Nenni’s Socialist Party, in the mid-1950s,32 to start the rapprochement that would have led PSI to try the unification with PSDI, and eventually left both parties on a much more moderate position along the political spectrum than what traditional Socialist ideology suggested;33 in this decade-long development, the foreign policy balance between transatlantic loyalty and European visions played a major role in shaping these parties’ views in all areas of policy.

All in all, it seems that the evidence gathered, and the debate that has been rebuilt starting from it, made it possible to outline the major change in the monetary policy views of the Italian parties that embarked on the quadripartito governmental coalition during the 1960s, a shift that took place after the summer of 1971 as a consequence of the collapse of the Breton Woods monetary system, and more specifically, very soon after President Nixon’s decision of 15 August of that year.34 Such a shift in policy views had a large impact on the choices that were taken both by the government, as the official expression of the coalition, and by the Bank of Italy, as directed by people loyal to the Christian Democratic doctrine, in the logic of the clientela which was a distinctive trait

30 Ugo La Malfa, Gente, year XVI, n. 4, 23 January 1972, p.2.
of the management of DC during that period.\textsuperscript{35} Even though tracking down these processes is extremely complicated in a multi-party system as was Italy in the post-war era, in this case the analysis of the interaction between the political parties made it possible to reach a rather unambiguous final result of aligned views oriented towards European integration.

4. THE BROADER EUROPEAN PICTURE

To what extent is it possible to consider the United Kingdom and Italy as being representative of a broader pool, as if European policy-makers at large formed a sort of like-minded network allowing for a generalization of these conclusions, in order to make a somewhat wider claim?

Without forgetting that everything that is going to be said is necessarily an approximation of the actual reality, and inviting the reader to consider the conclusions of this study as an incentive to extend the exercise which has been attempted here to other relevant players in the European game - notably, at least France and West Germany - some elements suggest that a comparison between the British and Italian experiences might result in a good generalization of a Europe-wide feeling about the evolution of monetary regimes. These elements, already introduced at the beginning while explaining the reason for the choice of these two countries, seem to have now acquired an even stronger force. On many levels, indeed, the case studies highlighted that the two countries were at opposite ends of the policy-making spectrum. One was an enthusiastic founder of the EEC; the other was about to join, but a wide opposition front operated within its establishment. One had lost the war, the other was among its winners, even if both national economies had been left in ruins pretty much the same way.\textsuperscript{36} One had a single large party around which all other parties orbited, and despite this feature it had very weak and short cabinets, while the other had a quasi-perfect bipolar system with stable governments. One had trade unions organized around ideologies that never really managed to express one single political view, the other had functional trade unions that gathered in one single body, which made lobbying much easier. One hosted an important financial centre, while in the other, financial markets were not even developed enough to fulfil the developmental needs of domestic firms.

As is easy to observe, in terms of each of these elements, most times the remaining European countries placed themselves somewhere in between. Hence the idea that a comparison between national cases which, in so many instances, are placed at opposite ends, could offer a good median view of the general situation in Europe.

Of course, several exceptions must be mentioned. De Gaulle’s France clearly stood out of the picture, its traditional Euro-scepticism being coupled with an Atlantic scepticism and creating situations that could not easily be explained and catalogued, such as the mid-1960s threats that France might return to a pure gold standard and therefore send all of its dollar reserves back to the issuer.\textsuperscript{37} However, it must also be noted that after De Gaulle’s retirement, Pompidou’s policies became much more aligned with those of the rest of Europe.\textsuperscript{38}

Likewise, West Germany started from a peculiar position: somewhat bound to American loyalty for historical reasons,\textsuperscript{39} at some stage its authorities no longer managed to defend the dollar deficit and decided to let the currency float before the actual collapse of Bretton Woods. Moreover, the strength of the German economy, which already made it a net payer in the EEC’s budget, also meant that in a European monetary union, the Deutschmark would become the currency whose stability would ensure stability to other currencies, rather than being itself in search for stability.

Even with such different starting points that could be hardlycatalogued, in the end these countries made choices very much in line with what the present study argues, that is, a shift away from transatlantic loyalty and an ever stronger entanglement with Europe.

Some elements - that suggest a positive answer to the question over the possibility to generalize the conclusions of the British and Italian cases - stem from the results of the


\textsuperscript{36} As journalist Enzo Biagi put it, “Wars are won or lost by nations, not by people; the latter always lose.”


case studies themselves, and in particular from the cross-border similarities in the behaviour of different actors belonging to similar categories. Indeed, despite the structural dissimilarities between many features of the two political systems, several common traits could be outlined.

The most important of such traits is the emergence of the idea that a European monetary system might actually represent an alternative, as opposed to a complement, of Bretton Woods: this shift of views took place at around the same time within those circles that had previously sustained the complementarity of the two arrangements, as in the old-fashioned version of European unity that had been promoted by the early post-war US administrations.40 Such a shift was visible both in the governments and in the central banks of both countries. Britain experienced a clearer watershed with the 1967 devaluation, while in Italy these views started to emerge around 1969, when the Hague communiqué opened the way to the possibility of such integration, and at the same time trade unionist pressures and other forms of economic trouble made the monetary situation less and less sustainable.

A second common trait is that the domestic debate tended to be organized along two broad streams of thought. On the one hand were those who initially supported transatlantic loyalty and had looked at European integration as a by-product of it, to then swing towards the Werner Plan after the collapse of Bretton Woods. On the other hand were the traditional anti-Americans: these people had never looked at Bretton Woods as something good for the international community, nor were they looking at Europe or a European monetary system in such a light. Curiously enough, midway positions outside these two broad groups were not significant in either of the countries studied. Moreover, the supporters of the one and of the other view were similar in nature and, generally, also in their position at the time of the events looked at: the Italian Christian Democrats, their allies and the central bank were aligned with the transatlantic view, just as the British Tory government and the Bank of England; while opposition and trade unions - typical detractors of Europe, with the sole exception of Labour between 1966 and 1970 - ended up playing against European integration.

Organized business and finance tended to be in favour of their specific economic interest, creating a rather fuzzy picture, support being split between both views. Of course exceptions have to be made to this pattern, and were indeed made while unfolding the case studies: for instance, Ugo La Malfa’s Republican Party was afraid to find in Europe a potential weakening of the transatlantic link, despite being in the cabinet; and it has been widely described how minorities within both the Labour and the Tory parties sometimes created cross-party alliances, thus challenging the mainstream views. But as a general picture, it can be affirmed that a high degree of compliance to this pattern could be found in both countries.

One further trait that British and Italian policy-makers shared is that exogenous changes such as the dollar deficit and the “benign neglect” deeply affected their way of conceiving domestic problems: issues that would otherwise remain confined to domestic policy management - such as for instance the use of anti-cyclical monetary policies in order to offset rising inflation without possibly hindering productivity, as opposed to raising nominal wages41 - suddenly became international problems, and as has been pointed out, it is not by chance that both Phillips’s elaboration of the Keynesian trade-off between inflation and unemployment, as well as Mundell and Fleming’s “impossible trinity” theory, were already widespread by the early 1960s,42 while Friedman’s critique of such views began to spread later in the decade, that is, once it had become clear that something was going wrong.43

5. DRAWING A CONSEQUENTIAL LINK

If the existence of such evident similarities may be convincing when it comes to affirming that the case studies analyzed here are representative of the general attitude of most European countries, then it is worth looking at one further similarity, that possibly sums up all those that have been taken into account so far: in both case studies, archival

While the exogenous solution would verify the thesis advanced at the beginning, the endogenous one would actually leave Bretton Woods on the background of a much wider set of policy problems influenced by, but not mechanically consequent to, the worldwide monetary system’s breakdown. While both case studies showed quite clearly that at least part of the story was due to strategic views emerging as a consequence of the demise of Bretton Woods, one should still imagine a counterfactual scenario in which, all other elements equal, a higher degree of stability in terms of economic theory might have led to a different domestic management of the economies involved, which in turn might have stabilized the international situation and finally avoided the floating experiences that took place from 1971 onwards.

In favour of this view is the evolution of economic analysis during the post-war period, sketched out in Chapter 2, which pointed out that a longer-term sight in terms of domestic balance between internal and external targets might have helped European countries deal with the simultaneous occurrence of endogenous and exogenous inflationary pressures; a position that was also confirmed while looking more closely at the policies that were actually implemented in the domestic arenas in the run-up to 1971. Moreover, political reasons shadowed another major way out of the trouble, that would have been to float all currencies as soon as the problem started to come out in the mid-1960s, and at the same time transform the EMA from voluntary to compulsory - a de facto precursor of Werner’s “monetary snake” - so as to save the advantages of exchange rates stability within the EEC common market.

However reasonable these observations might be, the former is harmless to the thesis: if verified, it would just add the lack of economic knowledge to the reasons why European monetary integration was more of a reaction to the collapse of Bretton Woods than a stand-alone event. On its part, the latter had to deal with a larger problem: it was not fit for being politicized, as it would have triggered diplomatic incidents much larger than the problem it was trying to address. Even the endogenous version of the story,

therefore, points towards a scenario in which the start of the “monetary snake” followed
Bretton Woods as part of a sort of causal chain triggered by foreign events.

This conclusion is reaffirmed if one looks at the national pictures emerging from the
two case studies: while some actors were already in line with an Atlanticist loyalty that
also included a degree of Europeanism, other actors derived their anti-Europeanism
from a general anti-American, and usually also anti-capitalist, stance. While the former
remained in their positions - with some notable exceptions such as La Malfa’s criticism
of the American deficit - it is a fact that the latter had to undergo, if not a conversion, at
least an acceptance of European integration as a tidal historical process that was taking
place and which it would have been unrealistic to oppose. Such a change was visible for
example in the main representatives of trade unionism, the British TUC 56 and the Italian
CGIL, 57 but also in certain political parties in the case of Italy 58 and in the originally
anti-Europe factions of the two British parties. 59 What is important to note is that the
documents witnessing this change date between 1968 and 1973, and there is no reason
why such “forced” Europeanization should have taken place during those years, if not
that these were the years around the monetary crisis. In the case of the UK, one would
be tempted to say that these were also the years that followed the Labour Party’s
conversion to Europeanism, after Harold Wilson’s U-turn of 1966. 60 But frankly such
explanation cannot reasonably hold for many of the processes presented earlier in the
case study: why should Wilson’s conversion have triggered the pro-Europe monetary
strategy endorsed by the Conservative Research Department since 1968? 61 If anything,
it is a monetary event, namely the 1967 devaluation, which is more likely to have

56 See for instance “EFTA is Compatible with Sovereignty” in Nicholas Kaldor, The Common Market -
Also, “Draft Statement on International Monetary Reform”; ICFTU Working Group on International
Monetary Questions, TUC Archive, MSS/292D/409/2, 15 September 1972.
57 “[... ] our position, as CGIL, has always been that of recognizing the objective nature of the processes
of economic integration in Europe.” UIL Archive, V Congresso Confederale, Settimo di Agostino Novella
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pp. 77-78.
58 Fondazione Turati, Fondo PSI, Direzione Nazionale, Dipartimento Internazionale, ss. C, b. 26, 14
59 Conservative Research Department, Steering Committee, AHN/VB, SC(7318), 15 February 1973.
61 Conservative Party Archive, CCO 507/3, Annual Conference Papers, 1968-74, CCOC 255, Possible
Alternatives to EEC Membership, 1 April 1968, p. 24.

triggered this change. 62 Likewise, it is difficult to believe that Labour’s new European
stance was at the basis of the TUC choice to accept Europe as a positive element in the
international order since 1973, given that seven years separated the two events. As to
Italy, one interesting element was that the advent of the right-wing DC cabinet led by
Andreotti, replacing the previous one led by Colombo, should in theory have brought
more conservative, Atlanticist ideas into the Italian government’s foreign policy,
thereby limiting support for a European monetary arrangement which, as clearly
emerged by early 1972, was conceived as a regional solution that would allow EEC
countries to more easily give up Bretton Woods. 63 Andreotti, however, was at least as
much a European as he was an Atlanticist, 64 in this marking a clear difference from the
remainder of his political wing. This might explain, as said, his decision to enter the
“monetary snake” straight away after its inauguration in the spring of 1972. 65 The
continuity of pro-Europe views between the two cabinets emerging from different
c coalitions was, therefore, rooted in the respective leaders’ views, rather than simply
being a product of contingency planning (despite the latter certainly explaining some
aspects of the story). But is it sensible to connect such firm Christian Democrat
Europeanism to the choice made by other parties of the coalition to endorse the
European developments of the late 1960s, after the Hague communiqué? Hardly so: on
any political issue, it was more advantageous for these parties to disagree with their
main ally than to fully agree, in order to mark a difference that would earn them votes.
Moreover, it is unclear how DC Europeanism could make groups such as the
Communist Party, the leftist trade unions, the smaller agricultural producers and so
forth, shift their views towards Europe after the demise of Bretton Woods. All in all,
then, it was probably this event and its international consequences, rather than other
domestic drivers, that generated the shift of most opinion towards a Europe-centred
policy-making, an idea which also extended to the monetary field through Werner’s
“snake”. 66
Finally, a consideration of a more economic as well as historical nature seems to reassure about the fact that the Italian and British political arenas were a representative mirror of the other continental EEC partners: all European countries had enjoyed a catch-up effect after World War II, and all of them had enjoyed the US playing "with one hand tied behind her back". All of them, therefore, had experienced a domestic-driven slowdown in competitiveness while the 1960s went on; at the same time, the exogenous events, mainly the American deficit that translated into the "dollar glut", had worsened this picture in the same way for all countries. The different political stance of the French and West German governments should not mislead the reader: indeed, the more American-friendly West Germany left the Breton Woods parity first, while General de Gaulle only managed to threaten to do that throughout the previous decade.

Eventually, then, it seems sensible to affirm that the change of strategic attitude that most of the actors involved in policy-making showed between 1971 and 1972 - or for some instances during the wider framework spanning from 1968 and 1973 - was due to exogenous causes, namely the monetary events of 1971 or, more broadly speaking, to the monetary crisis that preceded 1971 and that could be traced down to the 1967 British devaluation or, in the case of Italy, to the balance of payments troubles incurred in 1970. Such a conclusion may be extended to the general European mood insofar as, at first sight, policy-makers in all other countries involved reacted in quite a similar way to the events, although this claim should be taken more as a suggestion for future research than as a real conclusion.

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60 "At the end of World War II the economies of the major industrial nations of Europe and Asia were shattered. To help them get on their feet and to protect their freedom, the United States has provided over the past 25 years $143 billion in foreign aid. That was the right thing for us to do. Today, largely with our help, they have regained their vitality. They have become our strong competitors, and we welcome their success. But now that other nations are economically strong, the time has come for them to bear their fair share of the burden of defending freedom around the world. The time has come for exchange rates to be set straight and for the major nations to compete as equals. There is no longer any need for the United States to compete with one hand tied behind her back." Office of the Federal Register (ed.), Richard Nixon, containing the public messages, speeches and statements of the president - 1971. Washington: US Government Printing Office, 1972, pp. 886-890.


6. ATTEMPTS AT A DIFFERENT ENDING

Despite having warned the reader about the misleading effect of such a choice, the present research has been organized in a traditional way, that is, around national case studies. It occurred many times during the work, however, to notice that at least another reading of the situation would have been possible: that is, structuring the research around the different types of actors involved, trying to create the illusion of historiography by approximating each category's cross-boundary position on the issues considered, as opposed to grouping all the British and all the Italian actors with the respective national counterparts. It is perhaps worthwhile to wonder what this would lead to. Would the conclusions be any different, and if so, would they better approximate the reality of history?

As to be leading to different results, hardly could this be the case. While some groups of actors, such as political parties, were structured in a completely different way and therefore no correspondence could be made between the British and Italian cases, actually most of the groups with a clear parallel - trade unions, business associations, central banks - showed similar patterns of action, at least if one takes into account that, at any rate, structural differences existed in these instances as well: British trade unionism could never be compared to Italian trade unionism due to traditions, to a functional as opposed to ideological pattern of aggregation, to links with government, and so forth. Despite all that, for instance, the movements of workers in both countries found themselves to fight for similar goals in similar years - most importantly, wages in the late 1960s - and they also showed a similarly negative attitude towards the EEC until a - similar, again - conversion to a more European attitude after 1972. Business associations generally started from a more EEC-oriented point of view, with exceptions for those that represented businesses having to do with the geographical areas that would have possibly experienced difficulties, mainly the Sterling Area for the UK, the
CIA being the most vehement detractor of the dismantling of the existing arrangements, and the domestic territory for Italy, with smaller businesses often being more sceptical than their larger counterparts. Finally the two central banks could very easily be dealt with together, as the more stable leadership in both cases created distortions leading to what would later be referred to as a "democratic deficit" as well as a sort of bureaucratic takeover of monetary policy-making, whereby the central bank could reach the point of threatening retaliation against the government in case the latter had chosen certain policy lines unacceptable to a governor. Probably, then, to treat each category together and then form a sort of macro-case trying to reach an ultimate picture through this method would not have yielded substantially different results.

What remains of the main argument after all these analytical and methodological tests is that, from all the evidence gathered and the reasoning developed so far, it appears that, while before 1971 most actors seemed to wish to defend the Bretton Woods system and not everyone was openly favourable to European integration - which remained a delicate theme, given that both Tories and Labour suffered from internal nationalist minorities opposing integration, and that the compactness of the Italian governmental coalition was still weak against the main European detractor, the leftist trade unions - after 1971 the situation changed insofar as important actors came to look at Werner's snake as the most viable way out of the monetary crisis, while at the same time other traditional opponents of the EEC-based solution, notably the trade unions, started to realize there was no point in opposing integration any longer. Such evidence shows that the demise of Bretton Woods played a fundamental role in the British and Italian choice to try the European experience.

These conclusions are further reinforced by the observation that the UK would then abandon the "snake" after a while, and later on it would fail to join the further integration steps leading to the euro, while at the same time Italy negotiated a wider fluctuation band for its own currency, to then abandon the "snake" anyway; both these patterns, indeed, show very clearly that the European choice of 1972 had been based on contingent rather than long-term considerations, or to put it in a more romantic way, interest as opposed to love. Putting the event into a broader context, of course, it is still easy to understand why historians of the post-war era neglected the monetary choice that had been so difficultly taken in these years, as the whole story was to be greatly overshadowed by the much more sensational event represented by the oil price shock of late 1973, which would tend to monopolize any space possibly allocated to a monetary analysis of the early years of that decade. Indeed, the narrative developed here does not have a sensational appeal, as it simply describes the general short-sighted pattern every democratic regime tends to have by definition. However, as hopefully this research will have made clear, the light-headedness with which governments put themselves in the hands of contingency instead of long-term analysis should not make historians adopt the same attitude, as the issue upon which a choice had to be taken was actually one whose consequences would have stretched for decades to come. In fact, to say the least, the hurried adoption of the "snake" would heavily contribute to the emergence of its early problems, which in turn acted as a magnifier for the other troubles the world economy suffered from during the remainder of the decade, which accidentally were the same that attracted most of the historians' attention in all mainstream narratives. These troubles had a deeper root in the monetary choices that were the subject of this research; had they been dealt with in a different way - for instance by creating a more effective hedging mechanism against external fluctuations in prices - perhaps the remainder of the decade would have looked quite different. Unfortunately, as history showed, and as should have been easy to guess even at the time, after a marriage of interest one can expect anything but a honey moon.

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86 Luciano Lama, Intervista sul sindacato, Bari, 1976, pp. 77-78.
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