“Disruption: Economic Globalization and the End of the Cold War Order in the 1970s”

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A Dissertation presented to the Graduate Faculty of the University of Virginia in Candidacy for the Degree of Doctor of Philosophy

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University of Virginia
August 2018

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Introduction

This dissertation argues that the economic globalization that swept over the world during the 1970s provides the key to understanding why the Cold War ended. During this decade, industrial states on both sides of the Cold War divide endured a series of shocks to their economic and financial structures. The Western capitalist states adapted to the new economic landscape; the socialist bloc states did not. While the end of the U.S.-Soviet geopolitical and ideological struggle cannot be reduced to a monocausal explanation, this dissertation provides extensive evidence that in a causal hierarchy of factors, the ascendency of neoliberalism and terminal decline of socialism as an economic system should be placed at the top of any explanation for the end of the Cold War. Material prosperity was central to both blocs' Cold War strategies. The complex economic shifts of the decade compelled all industrialized nations to rethink their strategies for navigating this new globalizing world. The fact that the socialist states failed to recover from the hammer blows of the 1970s signaled that the East had lost both its ability to "bring home the bacon" to a disgruntled population, as well as the ideological authority to wage the Cold War. Although the dramatic political endgame did not take place until 1989-1991, the Cold War as a matter of the East-West economic rivalry had ended by the start of the 1980s.

Virtually no scholar would deny that economic factors mattered greatly in bringing the Cold War to a close, but surprisingly few examine exactly how and why economics mattered. Instead, the majority of the literature focuses on the contributions of individual policymakers, principally Soviet General Secretary Mikhail Gorbachev and U.S. President Ronald Reagan, in ending the Cold War.[1] Shortly after the conflict ended, American "triumphalists" contended that

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[1] A few scholars have ventured into the 1970s, but they tend to stress the importance of social movements and human rights. See Sarah B. Snyder, *Human Rights Activism and the End of the Cold War: A Transnational History*

the Reagan administration developed a grand strategy that brought the Soviet Union to its knees and ended the Cold War.[2] The triumphalists tended to examine the end of the Cold War from the U.S. perspective only, with access to a limited number of archival materials. As the literature matured and scholars utilized a wider range of sources, particularly from behind the Iron Curtain, the scholarly consensus shifted to the importance of Gorbachev.[3] Others have highlighted the importance of Gorbachev while also crediting Reagan for his ability to inspire Gorbachev's trust.[4] According to this interpretation, the Cold War likely would have continued without these two transformative leaders. The historian Robert D. English asks: "were the far-reaching domestic changes unavoidable or 'objectively necessary' for the Soviet Union in the mid-1980s? And was economic crisis so deep that it also required a broad retreat from empire and 'suing for peace' in the global contest with the West on highly concessionary terms? The simple answer to these question is no."[5]

The "Gorbymania" that characterizes current scholarship illuminates much about why the Cold War ended when and how it did. Gorbachev represented a new generation of Soviet leaders

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of the Helsinki Network (Cambridge: Cambridge University Press, 2011); Daniel C. Thomas, *The Helsinki Effect: International Norms, Human Rights, and the Demise of Communism* (Princeton, NJ: Princeton University Press, 2001) and Jussi Hanhimäki, *The Rise and Fall of Détente: American Foreign Policy and the Transformation of the Cold War* (New York: Potomac Books, 2013).

[2] For a sample of the triumphalists, see Francis H. Marlo, *Planning Reagan's War: Conservative Strategists and America's Cold War Victory* (Washington, DC: Potomac Books 2012); Peter Schweizer, *Victory: The Reagan Administration's Secret Strategy that Hastened the Collapse of the Soviet Union* (New York: The Atlantic Monthly Press, 1994). For a rebuttal to the notion that Reagan had a grand strategy, see James Wilson, "How Grand Was Reagan's Strategy, 1976-1984?" *Diplomacy & Statecraft* vol. 18, no. 4 (December 2007): 773-803.

[3] Important works in this vein include: Archie Brown, Seven Years That Changed the World: Perestroika in Perspective (New York: Oxford University Press, 2007); Robert English, *Russia and the Idea of the West: Gorbachev, Intellectuals and the End of the Cold War* (New York: Columbia University Press, 2000); Mark Kramer, "The Demise of the Soviet Bloc," *Journal of Modern History* Vol. 83, No. 4 (2011): 788-854; Vladislav Zubok, *A Failed Empire* (Chapel Hill, NC: University of North Carolina, 2007).

[4] See, for example, Melvyn Leffler, *For the Soul of Mankind: The United States, the Soviet Union, and the Cold War* (New York: Hill and Wang, 2007); Robert Service, *The End of the Cold War 1985-1991* (New York: Public Affairs, 2015)James Graham Wilson, *The Triumph of Improvisation: Gorbachev's Adaptability, Reagan's Engagement, and the End of the Cold War* (Ithaca, NY: Cornell University, 2014).

[5] Robert D. English, "The Road(s) Not Taken: Causality and Contingency in Analysis of the Cold War's End," *Cold War Endgame: Oral History, Analysis, Debates*, ed. by William C. Wohlforth (University Park, PA: Pennsylvania State University Press, 2003), 244.

who had not served in the Great Patriotic War and worried less about the possibility of an attack from the West. Gorbachev's relationship with Reagan reinforced the former's conviction that nuclear war could be avoided.[6] Gorbachev's commitment to non-violence and human rights ensured that the revolutions of 1989 and the disintegration of the Soviet Union unfolded relatively peacefully. Gorbachev undoubtedly played a central role ending the division of Europe, German unification, bringing the arms race to a close, and winding down Soviet commitments in the global South. Other leaders could have made different decisions, and it is a tribute to Gorbachev that the collapse of communism in the East involved minimal bloodshed (Romania and Yugoslavia as the exceptions). The smooth political transition in Eastern Europe also required a delicate touch in Washington that encouraged reformers but did not antagonize or embarrass the Soviet leadership.

The shortcoming of the current scholarly emphasis on the agency of Gorbachev is that it reveals little about the foreign and domestic conditions that convinced Gorbachev that he had to act to reinvigorate socialism. Jeffrey A. Engel writes that Soviet policymakers in the late 1980s "needed to decide if they would go with the flow of history or against it."[7] The major question that needs to be answered about the end of the Cold War is why the "flow of history" moved toward Western capitalism and away from Soviet socialism in the first place. Scholars tend to take this for granted by focusing on the period between Gorbachev's rise to power in March 1985 and the collapse of the Soviet Union in December 1991. It may seem obvious on the surface, but scholars also need to grapple more seriously with the question of why the Eastern

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[6] On the importance of the generational shift in Soviet politics, see Vladislav Zubok, "Why Did the Cold War End in 1989," in *Reviewing the Cold War: Approaches, Interpretations, and Theory*, ed. by Odd Arne Westad (London: F. Cass, 2000), 343-67

[7] Jeffrey A. Engel, *When the World Seemed New: George H.W. Bush and the End of the Cold War* (New York: Houghton Mifflin Harcourt, 2017), 5.

European governments and Soviet successor states liberalized so quickly after the collapse of socialism and joined Western financial institutions such as the IMF (and several had done so before the revolutions).

Changes in the global economy in the 1970s provide much of the answer, namely the extent to which the West adapted and the East failed to adapt to economic globalization. Drawing on archival research in Austria, Britain, Bulgaria, France, Germany, the Netherlands, Russia, and the United States, this dissertation argues that the resurgence of capitalism and the terminal decline of socialism by the early 1980s overdetermined the end of the Cold War.[8] This dissertation does not examine the Cold War endgame itself; others have explored the delicate politics and social movements of 1985-1991.[9] It seeks instead to illuminate the structural conditions that made the end of the Cold War possible.

Rather than look to the 1980s, this dissertation examines the 1970s as the decisive years for the end of the Cold War. The outcome was not yet clear to observers in the 1970s. The United States was always "distinctly more 'super'" than the Soviet Union, the historian Odd Arne Westad notes.[10] But the attraction of socialism rested on its promise for the future, not its current levels of production. During the famous Kitchen Debate in July 1959 with U.S. Vice

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[8] This argument comports with Scott G. Brooks and William C. Wohlforth, "Economic Constraints and the End of the Cold War," in *Cold War Endgame*, 273-309. Brooks and Wohlforth contend that economic constraints in the East made a Western victory in the Cold War "very likely" by the early 1980s.

[9] For studies that focus on the relations For analyses of the 1989 revolutions, see Timothy Garton Ash, *The Magic Lantern: The Revolutions of '89 Witnessed in Warsaw, Budapest, Berlin and Prague* (New York: Random House, 1990); Jacques Lévesque, *The Enigma of 1989: The USSR and the Liberation of Eastern Europe*, tr. By Keith Martin (Berkeley, CA: University of California Press, 1997).
On German unification, see Mary Elise Sarotte, *1989: The Struggle to Create Post-Cold War Europe* (Princeton, NJ: Princeton University Press, 2009) and *The Collapse: The Accidental Opening of the Berlin Wall* (New York: Basic Books, 2014); Philip Zelikow and Condoleezza Rice, *Germany Unified and Europe Transformed: A Study in Statecraft* (Cambridge, MA: Harvard University Press, 1995).
On the contributions of George H.W. Bush to the end of bipolarity in Europe, see Engel, *When the World Seemed New*.

[10] Odd Arne Westad, *The Global Cold War: Third World Interventions and the Making of Our Times* (New York: Cambridge University Press, 2007), 403.

President Richard Nixon, Soviet First Secretary Nikita Khrushchev boasted that "as we pass you by, we'll wave 'hi' to you, and then if you want, we'll stop and say, 'please come along behind us.'"[11] By the end of the 1970s, however, it was clear to all that socialism's surge ahead of capitalism would not materialize. As the socialists struggled to finance basic domestic consumption, "communist promises of future consumer abundance seemed increasingly hollow," historian Emily Rosenberg writes.[12] "What is communism?" a popular joke went in Poland. "It is when everything will be available in stores. In other words, like it was before the revolution."[13]

Western capitalism did not outperform Soviet socialism in isolation from one another. Most scholars tend to separate the eras of stagflation in the West and *zastoi* (stagnation) in the East during the 1970s, but this dissertation views them as part of the same process.[14] Economic globalization provides a framework that unites the economic histories of both halves of the global North. In a recent essay, the historian Charles S. Maier asked what relationship the crises that afflicted the West in the 1970s had with the collapse of communism the following decade. "Most narratives make no connection between the two," he writes, "but I would urge that they represented…two phases of one epoch of unrest confronting the industrial world–capitalist and communist."[15] This dissertation takes on the challenge that Maier has framed and evaluates the

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[11] "The Kitchen Debate-Transcript," July 24, 1959, CIA Reading Room, https://www.cia.gov/library/readingroom/docs/1959-07-24.pdf.
[12] Emily S. Rosenberg, "Consumer Capitalism and the End of the Cold War," in *The Cambridge History of the Cold War, Volume II: Crises and Détente*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), 508.
[13] Westad, *The Cold War*, 510.
[14] See Michael Dobbs, *Down with Big Brother: The Fall of the Soviet Empire* (London: Bloomsbury, 1997); Philip Hanson, The Rise and Fall of the Soviet Economy: An Economic History of the USSR from 1945 (New York: Longman, 2003); David Remnick, *Lenin's Tomb: The Last Days of the Soviet Empire* (New York: Vintage Books, 1994). In an important new book, Chris Miller contends that the agricultural, military, and energy interest groups made Gorbachev's reforms impossible. See *The Struggle to Save the Soviet Economy: Mikhail Gorbachev and the Collapse of the USSR* (Chapel Hill, NC: North Carolina Press, 2016).
[15] Charles S. Maier, "Malaise," in *The Shock of the Global: The 1970s in Perspective*, ed. by Niall Ferguson, Charles S. Maier, Erez Manela, and Daniel J. Sargent (Cambridge, MA: Harvard University Press, 2010), 45. Maier had been thinking in these terms since the end of the Cold War. See "The Collapse of Communism: Approaches for a Future History," *History Workshop*, no. 31 (spring 1991): 34-59; *Dissolution: The Crisis of Communism and the*

extent to which the global economic shocks of the 1970s transcended the Iron Curtain and posed challenges to capitalist and socialist states alike. As advanced industrial economies, they shared a common dependence on international trade and capital to make their societies function. No country, not even the United States or Soviet Union, had the resources to be self-sufficient, and all relied on access to finance and products beyond their borders. The economic shocks of the 1970s–formation of global financial markets, upheaval in the international monetary system, and the energy shocks–disrupted the postwar international economic system, forcing policymakers to account for these structural changes and develop new strategies.

In this dissertation, economic globalization is defined as the convergence of national markets and flows of capital and goods across the world, processes that created interdependence among members of the international system. It was driven by increased international trade, the removal of capital controls, and higher consumption rates, and facilitated by technological advances.[16] Although use of the term "globalization" did not become popular until the 1990s, contemporaries of the 1970s identified it as a reality of their time. Rather than call it globalization, Western policymakers generally referred to it as "economic interdependence" or "complex interdependence."[17] The understanding that interdependence accelerated in the 1970s

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Collapse of East Germany (Princeton, NJ: Princeton University Press, 1996). Several other historians such as Jeffrey Kopstein and Stephen Kotkin have also made this connection, but no work has thus far documented it by relying on archival documents from both sides of the Iron Curtain. See Jeffrey Kopstein, *The Politics of Economic Decline in East Germany, 1945-1989* (Chapel Hill, NC: University of North Carolina Press, 1997); Stephen Kotkin *Armageddon Averted: The Soviet Collapse, 1970-2000* (New York: Oxford University Press, 2001); Stephen Kotkin with Jan Gross, *Uncivil Society: 1989 and the Implosion of the Communist Establishment* (New York: Modern Library, 2009).

[16] Other components of globalization such as culture are not considered here. Technology also falls outside of the scope of this dissertation. For an introduction to the subject, see David Reynolds, "Science, Technology, and the Cold War," in *The Cambridge History of the Cold War, Volume III: Endings*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), 23-44.

[17] Recognition of this phenomenon reached beyond policy circles, and an academic literature soon blossomed. Led by scholars such as Yale economist Richard Cooper and Harvard political scientists Joseph Nye and Robert Keohane, academics debated economic interdependence's implications for governance and the extent to which the international system had fundamentally changed. See Richard N. Cooper, *The Economics of Interdependence:*

provided the intellectual framework for the Trilateral Commission, an organization founded in July 1973 by John Rockefeller to encourage political and economic dialogue among the United States, Western Europe, and Japan to solve common problems. "The international system is undergoing fundamental changes which could enhance the likelihood of economic, political and ecological breakdown," a 1977 Trilateral Commission report stated. "There is no alternative to approaching them jointly with a will to influence the course of events."[18]

Behind the Iron Curtain, socialists also recognized the accelerating interdependence of the global economy and their increasing vulnerability to it. The socialist states abandoned autarky and adopted economic development strategies in the late 1960s and early 1970s that required large imports of capital and products from the West to compensate for socialism's shortcomings. They cast their expanding trade relationship with the capitalists as an expression of peaceful coexistence. "The Soviet Union never aspired to autarky," the Soviet Trade Minister Nikolai Patolichev assured the West German Economics Minister Hans Friderichs in March 1976.[19] As their dependence on the West grew, however, they became increasingly susceptible to the economic shocks wreaking havoc on the capitalist world.

Economic globalization posed a threat because it eroded the distinction between domestic and foreign policy. To one extent or another, capitalist and socialist governments all had social contracts with their populations, promising social services and full employment. Economic globalization made achieving these goals more difficult. Officials increasingly had to ensure that they kept the trust of foreigner creditors, as well as the people who elected them or in whose

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Economic Policy in the Atlantic Community (New York: McGraw-Hill, 1968); Robert O. Keohane and Joseph S. Nye, *Power and Interdependence: World Politics in Transition* (Boston, MA: Little, Brown, 1977).

[18] Report of the Trilateral Task Force on a Renovated International System, "Towards a Renovated International System," November 1976, United Kingdom National Archives, London, England, FCO 49/768.

[19] "Zapis' besedy: Ministra vneshney torgovli tov. Patolicheva N.S. s Ministrom ekonomiki FRG g-nom Kh. Friderikhs," March 30, 1976, Rossiiskii gosudarstvennyi arkhiv ekonomiki, Moscow, Russia, f. 413, op. 31, d. 8237.

name they ruled. The welfare state depended on a high level of spending on social programs, but bloated budgets scared foreign holders of debt. The emergence of global financial markets meant that governments could not accumulate large trade deficits because creditors would dump the debt for safer destinations or refuse to extend further credits. As U.S. Deputy Secretary of State Charles W. Robinson wrote in December 1976, "The design and direction of U.S. foreign policy must be founded on the reality of an expanding economic interdependence between nations. The development of the world political order has become inseparable from the evolution of the international economic system; thus foreign policy has become inseparable from economic policy."[20] In the socialist bloc, officials recognized a similar dynamic. "The problems of foreign economic policy are not just problems of diplomacy," the chairman of the East German State Planning Commission Gerhard Schürer observed in March 1973, "but rather problems that affect the entire national economy."[21] Thus, developing an effective strategy to manage economic globalization was motivated in part by a desire to ensure that it did not intrude on the social contract.

It is commonplace to describe the Cold War as a competition between capitalism and socialism, the free market and state planning. It is a convenient shorthand (and is used in this dissertation), but classifying the political economies of the global North into only two categories can be misleading. In the West, the state played a decisive role in promoting economic growth and providing safety nets to those for whom the free market did not work.[22] In the East,

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[20] Phrases underlined in the original. Charles W. Robinson to Philip Habib, "State-Treasury Relations," December 24, 1976, NARA, RG 59, Records of Deputy Secretary of State Charles W. Robinson, 1976-1977, D Chron Dec. 1976 & Jan 1977, Box 4.
[21] Staatliche Plankommission Staatssekretär, "Persönliche Niederschrift über eine Problemberatung beim Vorsitzenden des Ministerrates am 26.3.1973," March 27, 1973, Bundesarchiv, Berlin-Lichterfelde, Germany, DE 1/58580.
[22] On the interaction between the state and free markets in the West, particularly in a U.S. context, see Melvyn P. Leffler, "Victory: The 'State,' the 'West,' and the Cold War," reprinted in *Safeguarding Democratic Capitalism: U.S. Foreign Policy and National Security, 1920-2015* (Princeton, NJ: Princeton University Press, 2017).

socialism represented an extreme case of state involvement in the economy, but policymakers gradually permitted more private enterprises to coexist alongside state-owned industries. All states in the global North fell on a spectrum that indicated how much the state dictated the terms of the market, with no country occupying either extreme. For the first time in the postwar period, the free market won over the state in the mid 1970s, and all countries were forced to move to the right on the spectrum in order to satisfy foreign markets.

This dissertation aligns with an emerging literature that identifies globalization as an alternative paradigm to the Cold War for understanding international affairs in the 1970s.[23] The Cold War remained a central preoccupation for policymakers on both sides of the Iron Curtain, and détente was a dominant feature of superpower relations during this period. Yet the Cold War, as Westad writes, "was not the only game in town; the late twentieth century saw many important historical developments that were neither created by the Cold War nor determined by it."[24] Globalization was the primary transnational development that drove change in the 1970s. Reflecting in spring 1975 on the disruptions in the global economic system, the U.S. State Department concluded that "neither Communist nations nor East-West relationships have played a central role in recent institutional changes, or in decisions and debates about the world economic system."[25] Most of the work on the intersection of diplomacy and globalization has

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[23] Prominent works on the 1970s that focus on the Cold War include John Lewis Gaddis, *Strategies of Containment: A Critical Appraisal of Postwar American National Security Policy* (New York: Oxford University Press, 1982); Raymond Garthoff, *Détente and Confrontation: American-Soviet Relations From Nixon to Reagan* (Washington, DC: The Brookings Institution, 1994); Melvyn P. Leffler, *For the Soul of Mankind: The United States, the Soviet Union, and the Cold War* (New York: Hill and Wang, 2007); Odd Arne Westad, *The Global Cold War* (New York: Cambridge University Press, 2007); Barbara Zanchetta, *The Transformation of American International Power in the 1970s* (New York: Cambridge University Press, 2014), Vladislav Zubok, *A Failed Empire: The Soviet Union in the Cold War from Stalin to Gorbachev* (Chapel Hill, NC: The University of North Carolina Press, 2009).
[24] Odd Arne Westad, *The Cold War: A World History* (New York: Basic Books, 2017), 2.
[25] U.S. Discussion Paper, "Trade and Natural Resources in the East-West Context," undated (but prepared for discussion for NATO meeting in April 1975), NARA, RG 59, Records of Henry Kissinger, Briefing Memos, 1975 Folder 6, Box 14.

focused on the "view from Washington," examining how U.S. policymakers grappled with threats beyond the Cold War.[26] A body of literature that uses European and Soviet perspectives and sources has yet to develop.[27] This dissertation seeks to help fill that gap, demonstrating that while the United States remained the most powerful nation in the world, it had to act within a community of interests in an increasingly interdependent world. This approach offers a more comprehensive understanding of economic globalization because the United States, Europe, and the Soviet Union were integrated into the global economy to different degrees, and economic globalization impacted them all.

The intersection of economic globalization and the Cold War is a central theme that runs through the dissertation. The post-Cold War order emerged even as the Cold War continued to rage. In Washington, for example, grand strategy focused on containing communism, principally driven by Moscow, during the early years of the Cold War. U.S. policymakers, however, increasingly had to identify a larger set of threats, many of which existed outside of, but intersected, the Cold War. As the director of the State Department Policy Planning Staff Winston Lord wrote in November 1975,

> the postwar era ended in the late 1960s….We are now acutely aware of the great range of issues that arise from an increasingly interdependent world. Our concern with the problems of an interdependent world is an important step beyond our concern with a polarized world….Yet problems of the earlier era remain with us….The heritage of the Cold War is by no means past….Thus we have heavy and

[26] Problems that existed "beyond the Cold War," included globalization, human rights, population control, and decolonization. Influential works include Paul Thomas Chamberlain, *The Global Offensive: The United States, the Palestine Liberation Organization, and the Making of the Post-Cold War Order* (New York: Oxford University Press, 2012); Matthew Connally, A Diplomatic Revolution: Algeria's Fight for Independence and the Origins of the Post-Cold War Era (Oxford: Oxford University Press, 2002); Francis J. Gavin and Mark Atwood Lawrence, eds., *Beyond the Cold War: Lyndon Johnson and the New Global Challenges of the 1960s* (New York: Oxford University Press, 2014); Niall Ferguson, Charles S. Maier, Erez Manela, and Daniel J. Sargent, eds., *The Shock of the Global: The 1970s in Perspective* (Cambridge, MA: Harvard University Press, 2010); and Daniel J. Sargent, *A Superpower Transformed: The Remaking of American Foreign Relations in the 1970s* (New York: Oxford University Press, 2015).
[27] Two exceptions are Giuliano Garavini, *After Empires: European Integration, Decolonization, and the Challenge from the Global South* (Oxford University Press, 2012); Oscar Sanchez-Sibony, *Red Globalization: The Political Economy of the Soviet Cold War from Stalin to Khrushchev* (New York: Cambridge University Press, 2014).

> complicated demands on our foreign policy making, as we deal with such a wide range of problems.[28]

Economic globalization was the dominant problem beyond the Cold War in the 1970s. The intersection of economic globalization and Cold War forced policymakers to reevaluate how they would identify objectives, rank priorities, and allocate resources to achieve their core goals. The superpowers, for example, had to balance their hegemonic responsibilities in their respective blocs under new economic conditions that threatened stability at home. Should Washington treat Western Europe and Japan as economic rivals as they all sought access to energy during the 1973-74 oil crisis? Or should the Richard Nixon administration instead consider them allies whose economic interests needed to be protected in the name of Cold War politics? Similarly, should the Soviet Union try to capitalize on the oil crisis to export energy to the West for hard currency, which Moscow needed for purchases of grain and other products to compensate for domestic shortages? Or should the Soviet Union instead forgo its own national economic interests and redirect that oil to Eastern Europe in order to protect the viability of socialism for its Cold War allies? These were not easy questions to answer.

The industrial democracies gradually adapted and embraced the forces of economic globalization, establishing the roots of a post-Cold War order based on neoliberalism. Neoliberalism refers to a broad set of principles that promoted free trade, privatization, reductions in government spending and taxes, the rollback of state interference in the economy, and deference to the free market. As policymakers permitted forces of economic globalization to gain speed, the welfare state became increasingly untenable. “The new order is already with us,” West German Chancellor Helmut Schmidt told British Prime Minister Margaret Thatcher in

[28] Winston Lord to Henry A. Kissinger, “Presidential Foreign Policy Review,” November 28, 1975, National Archives and Records Administration, College Park, MD, Record Group 59, Policy Planning Staff, Director’s Files (Winston Lord) 1969-77, Nov. 16-30, 1975, Box 359.

November 1980. "Neither J.M. Keynes nor Mr. Friedman had anticipated a situation where the industrialised world would be so dependent for a vital resource on 'outsiders.' They had thought in terms of a closed system of national economies."[29]

The ascendency of neoliberalism was not foreordained. It emerged because of a combination of impersonal structural factors and human agency. The rise of transnational capital and increased international trade forced policymakers to weigh the advantages of access to global markets against calls for protectionism at home. As deficits mounted, the West had to balance the social promises of the welfare state with the need to restore the trust of foreign lenders. Policymakers were constantly confronted with choices: should they shift the burden of adjustment of correcting deficits onto the people, or should they withdraw from the global economy and erect capital and trade controls to protect the social contract? Each country faced this decision, and each decided to reduce spending at home in order to ensure that they could continue to receive money from abroad. The British started the process in 1976 (and 1979), and were followed by the Americans (1978-79), West Germans (1982), French (1983), and the developing world. The second oil crisis and high interest rates precipitated a recession in the early 1980s that played a crucial corrective role, which finally eliminated inflation, lowered oil consumption levels, and attracted capital investments to finance government spending.

In addition to embracing neoliberal ideas about the role of government in the economy, the resurgence of capitalism by the early 1980s created structural adjustments in the balance of power within the West. In the first two decades of the Cold War, the United States operated as a "welfare empire," providing materials and assuming the bulk of the military burden against communism that allowed Western Europe and Japan to prosper. The pillars of "Pax Americana"

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[29] "Record of a Discussion Between the Prime Minister and Chancellor Helmut Schmidt in Bonn on 17 November at 0900 Hours," November 17, 1980, UKNA, PREM 19/471.

had been established during an extraordinary period in international affairs when the gap in economic and military power between the United States and the rest of the world was enormous.[30] By the late 1960s, this arrangement was unsustainable. This fact was demonstrated most profoundly by the unraveling of the Bretton Woods international monetary system that had depended on U.S. economic supremacy. Two decades later, Western Europe and Japan had recovered from the Second World War, and the flow of goods and finance in Pax America began to reverse. The Western Europeans and Japanese became global economic powers in their own right, capable of defying the United States. By the early 1980s, the United States depended on the inflow of capital and goods from the rest of the world. The willingness of foreigners, particularly West Germans and Japanese, to buy bonds and finance U.S. deficits provided the engine that helped lift the industrial democracies out of recession. The United States became an "inverted welfare empire"; rather than provide resources, it drew resources from the rest of the world.

The socialists faced similar choices. Unlike the West, however, they were unwilling to impose austerity measures to correct their deficits. At various points, socialists tried to discipline their people to help ease the debt burdens, but immediately changed course when the people protested. To avoid disaster during the Polish meat crisis in June 1976 or the East German coffee crisis in the summer of 1977, for example, regimes took out more loans from Western financial institutions. This only solved the problem in the short-term and indebted the socialists further. By the early 1980s, the level of debt and inability of socialist exports to raise hard currency to service those debts meant that the socialist bloc had reached its terminal crisis. Socialism was

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[30] On Pax Americana, see Sargent, *A Superpower Transformed*, 14-37.

fundamentally sick and could no longer be reformed.[31] Eastern Europe could only regain the trust of the international community by liberalizing and cutting back on government spending, violating central promises of the socialist system. In essence, what happened to the socialist bloc in the late 1980s and early 1990s was a replay of the U.S. and Western European embrace of austerity from 1976 to 1983. The fact that the socialists waited so long to adapt meant that the adjustment process was far more painful than it had been for the industrial democracies. It was ultimately fatal.

Just as the United States had served as a welfare empire for the West, the Soviet Union operated as one for the East. Unlike the United States, however, the Soviets could never manage to transition from the provider to the recipient. While the Western Europeans and Japanese developed robust economies of their own from which the United States could draw, the Eastern Europeans increasingly became a burden for the Soviets, not sources of economic strength. Eastern Europe survived into the 1970s on the backs of the Soviet Union to furnish raw materials and Western commercial banks to finance imports that they could not produce themselves. The 1975 price shocks in CMEA indicated that the Soviets were unwilling to tolerate further the burden of carrying Eastern Europe, particularly as Moscow struggled with its own economic shortcomings in the energy and agricultural sectors, among others. Socialism in Eastern Europe ceased not only to offer a compelling model of organizing political economy, but its very existence depended on life support provided by the West. The Polish crisis of 1980-81

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[31] The use of the word "sick" takes inspiration from Knut Borchardt, who characterized the economy in Weimar Germany from 1925 to 1929 as "abnormal, even…sick." He asked whether in this condition, Chancellor Heinrich Brüning could have saved the economy from slipping into depression. "No, constraints had developed which were so terrible that even today we still cannot present any real solutions." Although in a very different context, Borchardt's comments can be applied to socialism in the 1980s. See "Constrains and Room for Manoeuvre in the Great Depression of the Early Thirties: Towards a Revision of the Received Historical Picture," in *Perspectives on Modern German Economic History and Policy*, tr. By Peter Lambert (Cambridge: Cambridge University Press, 1991), 159, 157.

illuminated the limits of the Soviet Union's ability to act as a "lender of last resort" for the bloc. In an August 1981 diary entry, Soviet official Anatoly Chernyaev lamented that the Soviets "have failed to save the Polish people from hunger." The West had the capacity to help if it wanted, "but we *cannot* even with the best, most brotherly motives. And the whole world is watching this."[32] Rather than rely on the resources of their allies, as the United States did, the Soviet Union joined Eastern Europe as dependent on trade external to CMEA. The socialists' economic and political future was tied to Western financial institutions: capitalist banks were socialism's new master.

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Economic globalization fractured the postwar international system that existed from 1945 until the mid 1960s, and the first two chapters of the dissertation examine why the late 1960s marked a critical juncture in both the West and East. Chapter 1 tracks the effects that the emergence of transnational capital had on the Bretton Woods international monetary system. Bretton Woods had been one of the central institutions of the American-led international order that allowed the welfare state to coexist with international trade. Highly mobile funds that could transfer from one currency into another upset the delicate compromise, however, and compelled the change from fixed to floating exchange rates.

Chapter 2 then turns to the Eastern bloc. For the first two decades of its existence, the socialist bloc had utilized an autarkic development model, seeking a division of labor among the members of the Council for Mutual Economic Assistance (CMEA). As the members of CMEA reached the limits of extensive growth, they sought to compensate for their shortcomings by reentering the global economy. They wanted to reinvigorate socialism by importing technology

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[32] Diary entry for August 6, 1981, in Anatolii Chernyaev, *Sovmestyi iskhod: Dnevnik dvykh epoch 1972-1991 gody* (Moscow: Rosspen, 2008), 459.

and capital from the industrial democracies. They expected to combine Western materials with superior socialist labor to develop high quality exports, which would then be sold to the capitalists to repay their debts. The decision to reengage the global economy could not have come at a worse time, however. Rising inflation and the collapse of Bretton Woods in the capitalist world meant that socialists earned less from their exports than they expected, and the growing energy crisis in the Soviet Union limited energy exports in an age of skyrocketing demand in CMEA.

Chapter 3 investigates the diplomatic crisis that the crisis caused among the industrial democracies. The United States and Western Europe viewed the Arab-Israeli war differently: while Washington focused on how relations with Moscow were at stake in the war, Western Europeans viewed the war in terms of how it would affect their access to Middle Eastern oil. After the oil crisis erupted, the allies were divided on how to react. The United States sought to unite the consumers against the oil producers, but the Western Europeans–led by Paris–wanted to meet directly with the producers to negotiate a settlement. The two sides were able to reconcile their positions, but the Western strategy could not reverse the economic effects of the oil crisis. High prices became a permanent feature of international affairs for the next decade.

The dissertation then turns to question of how the industrial democracies adjusted to economic globalization. Chapter 4 investigates the origins of the neoliberal turn in the mid 1970s. Led by U.S. and West German policymakers, proponents of neoliberalism beat back statist alternatives. First, they successfully repelled an insurgency from the developing world to create a "New International Economic Order" that would transfer wealth from the global North to the global South and give developing countries a greater say in Western institutions. Second, they ensured that the market would facilitate the reinvestment of OPEC surpluses back into the

Western financial system. Third, they imposed a neoliberal solution on the British welfare state, encouraging the IMF to insist on large budget cuts in return for a loan. The British IMF crisis marked a watershed, as Britain became the first of the industrial democracies to embrace austerity as a means of regaining the trust of international financial institutions.

Chapter 5 then analyzes the "twin oil crises" behind the Iron Curtain. The Soviet Union could not meet the rising demand in Eastern Europe, so the socialists also had to pay the higher world oil prices to fulfill their consumption needs. The quadrupling of oil prices on the world market presented Moscow with a dilemma. Should the Soviets divert oil to the West, which could be sold for hard currency to pay for agricultural and other imports, or should Moscow continue to send it to Eastern Europe and continue to subsidize socialism there? The Soviets decided on the former. They also increased the price at which they sold oil to their Eastern European allies, indicating a growing recognition that their informal empire in Eastern Europe was a burden, not an asset. This price increase within the socialist world hurt the terms of trade within CMEA, and the Eastern Europeans were further forced into the arms of capitalist banks to finance imports.

Chapter 6 illuminates how the United States became the next to do so. Enormous deficits in 1977 and 1978, created largely by oil imports, made foreign holders of dollars worried that Washington was not serious about protecting the exchange rate of the dollar. It worried the Western Europeans as well. As a means of sheltering themselves from speculators fleeing the dollar, they created a European Monetary System designed to ensure that Washington did not export instability across the Atlantic. In the fall of 1978, the value of the dollar dropped propitiously. The Jimmy Carter administration announced an emergency package in November 1978 to protect the dollar. The following year his administration raised interest rates. These measures indicated that the administration was serious about maintaining the trust of the international community, even as those measures took a social and political toll at home.

Chapter 7 examines the resurgence of capitalism in the early 1980s. The turn to austerity provided the key. The second oil shock raised energy prices even further in 1979, but it also played an unexpected role in lowering inflation as the crisis wore on. Higher oil prices contributed to the onset of a recession, which finally limited oil consumption levels. High interest rates across the industrial democracies imposed discipline and lowered inflation rates, as governments managed to gain control over their money supplies. They also attracted capital from abroad that accelerated economic growth.

Finally, Chapter 8 tracks the onset of the terminal crisis in the socialist bloc. The combination of oil, finance, and austerity created an explosive situation in Poland in 1980-81. Eastern European debt skyrocketed in the late 1970s, but they were crowded out of the capital markets by the United States and Western Europe. Beset by internal agricultural and energy crises, the Soviet Union ceased to be the lender of last resort for the Eastern Europeans. Lacking capital and energy, the situation reached a boiling point in Poland. The Polish regime attempted to lower their deficit by limiting domestic consumption. The resulting Solidarity movement demonstrated the emptiness and impotency of the socialist regimes.

The process of adjusting to economic globalization came at a tremendous social cost for both West and East. The Western welfare state and its Eastern European socialist cousin had provided social services for their populations, keeping a safety net in place to guarantee a basic standard of living. As the neoliberal turn unfolded, the safety net did not disappear, but its reach did decrease significantly. In Detroit, for example, radio stations played country music songs to cater to the unemployed listeners. The 1977 song "Take This Job and Shove It" was adapted to:

"I Wish I had a Job to Shove."[33] Global inequality rose sharply in the 1970s as the oil shocks and inflation crippled the balance of payments for members of the developing world, and they–unlike the industrial democracies–struggled to attract investors to finance deficits. Capitalism did manage to recover from the shocks of the 1970s, but people around the world paid the price.

[33] William Greider, *Secrets of the Temple: How the Federal Reserve Runs the Country* (New York: Simon & Schuster, 1989), 454-55.

Chapter 1

"The Foreigners Are Out to Screw Us": Financial Globalization and the Collapse of Bretton Woods

Fearing the consequences of the British current account deficit and deteriorating labor relations, speculators rushed to sell sterling on June 15, 1972. By the following week, intervention by central banks across the industrial democracies to support the par value of sterling had cost the Bank of England $2.5 billion–at that rate, Britain would deplete the entirety of its $7.1 billion of reserves in less than three weeks. After facing heavy speculative pressure for eight days, the British Treasury announced on June 23 its decision to float the pound. The choice surprised many in Britain and abroad; only six weeks prior, the United Kingdom had joined the European Economic Community's "Snake in the Smithsonian tunnel," an agreement that narrowed the margins of exchange rates in an effort to synchronize monetary policy.[1] Prime Minister Edward Heath pointed to the "vast masses of highly mobile funds which can be switched out of one currency into another at very short notice and in enormous volume. What was done to the DM in Spring 1971, what happened to sterling last week, can be thrown at any currency however sound, whatever its support, and dislodge it from its accepted parity."[2]

Heath's counterparts across the industrial democracies shared his concern about the disruptive potential of transnational capital flows, and the assault on sterling in late June 1972 represented just one of a number of currency crises in the late 1960s and early 1970s that led to the unravelling of the Bretton Woods international monetary system. This chapter examines the

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[1] The "Snake in the Smithsonian tunnel" referred to an agreement among the European Community states in April 1972 that fixed Community currencies closer to each other than to the U.S. dollar. This will be discussed below.
[2] Heath speech on June 27, 1972, text included in Treasury Historical Memorandum No. 30, "The Collapse of the Bretton Woods System 1968-1973," October 1976, United Kingdom National Archives (UKNA), Kew, England, T 267/36.

collapse of Bretton Woods, paying particular attention to the impact of financial globalization in undermining the system of fixed exchange rates.[3] "The basic problem," a staffer in the U.S. Department of the Treasury wrote in June 1971, "is that in a world where short-term capital can move freely between money-market centers, an independent monetary policy becomes difficult to achieve."[4]

This chapter advances three arguments. First, it argues that the Western Europeans played a crucial and underappreciated role in dictating the manner in which Bretton Woods unraveled. Most scholars identify the U.S. deficits and inability to control inflation as the chief contributors to the collapse of Bretton Woods. Bretton Woods was fundamentally "sick" by the time Richard Nixon entered the presidency, the traditional interpretation suggests, and his decision to decouple the U.S. dollar from gold in August 1971 ended the fixed exchange rate system. Diane Kunz summarizes the prevailing interpretation when she writes, "The wheels of the Bretton Woods car kept spinning faster and faster until Richard Nixon finally drove it off the road."[5]

The U.S. role was undoubtedly significant, but Nixon was not the only "destroyer of Bretton Woods."[6] While the U.S. dollar lay at the center, this chapter stresses that it had to

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[3] Financial globalization refers to the process of integrating markets and cross-border financial flows, embodied the growing power of the Euromarket. This argument comports with new works such as Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton, NJ: Princeton University Press, 2015) and Daniel J. Sargent, *A Superpower Transformed: The Remaking of American Foreign Relations* (New York: Oxford University Press, 2015). More traditional arguments tend to emphasize the structural factors of the decline of U.S. economic relative to the growing strength of the European Economic Community and Japan, and the chronic U.S. balance of payments deficits. See, for example, Fred L. Block, *The Origins of the International Economic Disorder: A Study of United States International Monetary Policy from World War II to the Present* (Berkeley and Los Angeles: University of California Press, 1977); and David P. Calleo and Benjamin M. Rowland, *America and the World Political Economy: Atlantic Dreams and National Realities* (Bloomington, IN: Indiana University Press, 1973).

[4] Peter B. Clark to Wilson E. Schmidt, June 17, 1971, National Archives and Records Administration II (NARA), College Park, MD, Record Group (RG) 56, Office of Assistant Secretary for International Affairs (OASIA), Chronological Files of Deputy Assistant Secretary for International Monetary Affairs F. Lisle Widman, 1967-1978, Mr. Widman's Chron – August 1971, Box 4.

[5] Diane B. Kunz, *Butter and Guns: America's Cold War Economic Diplomacy* (New York: Free Press, 1997), 119.

[6] Ibid, 192. The purpose is not to shift the blame in a pejorative sense across the Atlantic. By all standards, the Nixon administration behaved poorly. The United States faced serious economic challenges and it is clear that Bretton Woods had to be reformed to account for the changes in the relative global economic balance of power, but

coexist within a larger world of national currencies and economies. Bretton Woods operated as a system.[7] Monetary wrangling and speculation was always underlined by real economic concerns, particularly trade and budget balances. U.S. deficits encouraged speculators to flee the dollar, but West German and Dutch surpluses also provided “pull” forces. When speculators believed that a currency such as the D-mark or guilder was undervalued, they rushed to put their money into the country in anticipation of a revaluation. When they believed that the pound or franc was overvalued, speculators fled, expecting a devaluation. Policymakers chose to allow their currencies to float because they feared the disruptive effects of hot money, particularly its inflationary pressure on domestic prices as well as its potential to deplete national reserves. Western European decisions to float their currencies at various points in 1967, 1969, 1971, 1972, and 1973 undermined confidence in the system of fixed exchange rates.

In his historiographical essay on the international political economy of the 1970s, Daniel J. Sargent notes that “a truly international history of the end of Bretton Woods, drawing on multiple national archives and sensitive to the roles of non-state actors still awaits.”[8] With the

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the Nixon administration consciously chose to forgo consultations with its allies and pursued a nationalistic economic policy. A good representative of the Nixon administration was Secretary of the Treasury John B. Connally, whom Henry Kissinger later described as “sufficiently Texan to relish a good scrap for its own sake.” Conally’s view was that “the foreigners are out to screw us and therefore it’s our job to screw them first.” See Henry A. Kissinger, *White House Years*, (Boston: Little Brown, 1979), 957; and George C. Herring, *From Colony to Superpower: U.S. Foreign Relations Since 1776* (New York: Oxford University Press, 2008), 782.

[7] William Glenn Gray’s articles on the disruptive effects of the D-mark’s power illustrates the value of examining West German behavior during the collapse of Bretton Woods, and this chapter expands on Gray’s framework by considering the contributions of other Western European currencies as well, notably the British pound, French franc, and Dutch guilder. See William Glenn Gray, “Floating the System: Germany, the United States, and the Breakdown of Bretton Woods, 1969–1973,” *Diplomatic History* 31, no. 2 (2007): 295-323; “’Number One in Europe’: The Startling Emergence of the Deutsche Mark, 1968-1969,” *Central European History*” 39, no. 1 (2006): 56-78; and “Toward a ‘Community of Stability’? The Deutsche Mark Between European and Atlantic Priorities, 1968-1973,” in *The Strained Alliance: U.S. European Relations From Nixon to Carter, ed. by Matthias Schulz and Thomas A. Schwartz* (Cambridge and New York: Cambridge University Press, 2010), 145-67. Harold James also makes an important contribution to the international aspects in his comprehensive treatment of international monetary policy after 1944, although he did not have the benefit of declassified government documents to conduct deep archival research in the relevant depositories. See James, *International Monetary Cooperation Since Bretton Woods* (New York: Oxford University Press, 1996).

[8] Sargent, “The Cold War and the International Political Economy in the 1970s,” *Cold War History* 13, no. 3 (2013): 403.

declassification of sources across the United States and Western Europe, this is now possible. While this chapter does not focus on non-state actors, it seeks to take a step toward providing an international history of Bretton Woods' collapse.

Second, the end of Bretton Woods threatened core U.S. overseas objectives in the Cold War. Washington's primary goal in the postwar period was to construct an international system based on liberal capitalism that would serve U.S. economic and political interests.[9] U.S. policymakers sought to combat protectionist sentiments at home and abroad, and tie the industrial centers of Western Europe and East Asia tightly to the American economy through mutually advantageous trade and financial relationships. This had utility for the fight against communism: close economic cooperation between the United States and its allies made it more difficult for Moscow to exert influence over areas that Washington deemed critical for national security. As inflation increased and the U.S. current account fell into deficit, the economic costs of maintaining Bretton Woods mounted. Much to the chagrin of the political elements of the administration such as National Security Adviser Henry A. Kissinger and the State Department, Nixon increasingly agreed with the economic departments of government such as Treasury and Commerce that it needed to pursue economic advantage over its allies to improve its trade balance. Kissinger scoffed at the idea of linking foreign policy priorities with economic

[9] The national security adviser's response to British Cabinet Secretary Burke Trend's query about why Europe mattered to the United States illustrated his thinking: "The importance of Europe to the United States is first, if there should be a Eurasia, either controlled from Moscow or effectively dominated by Moscow, we would then find that all other parts of the world, especially Latin America, would fall ideologically in that order. There are profound political consequences for the United States in the fields of: energy, the power balance, and the psychological cohesiveness of the United States, which would undergo unusual transformations. I think an extreme radicalization of American society would be the outcome. Initially on the right more than on the left. This is my guess, as would be a substantial demoralization of the American left…. Our ability to influence events in the world would gradually vanish. Never can we survive as an island in a totally hostile environment." "Memorandum of Conversation" [British/U.S.], April 19, 1973, RNPL, NSC Files, Henry A. Kissinger Office Files, Country Files – Europe, U.K. Memcons January-April 1973, Box 62.

limitations, saying "We are not going to give up our whole post-war foreign policy."[10] Unique among his presidential predecessors of the post-1945 era, however, Nixon "happen[ed] to tilt more to the…economic side."[11] The Treasury began to exert more influence over foreign policy, and Western Europe and Japan had to be seen as both economic rivals as well as political allies.

Finally, on the other side of the Atlantic financial globalization provided momentum for a renewed push for a European integration. The destabilizing effects of the speculative runs on the French franc and West German D-mark during 1968 and 1969–combined with the weakness of the U.S. dollar–reignited movement toward European integration that had stalled in the mid 1960s.[12] Policymakers attempted to create a regional monetary zone as a common response to the chaos that financial globalization had inflicted on the world economy. Seeking to shelter the gains of the Treaty of Rome and the Common Agricultural Policy from disruptive hot money, Paris and Bonn took the lead in setting the Community down the path of monetary integration at The Hague Conference in December 1969. Attempts to synchronize exchange rates after the

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[10] "Legislative Interdepartmental Group: Mansfield Resolution," May 12, 1971, RNPL, NSC Files, Name Files, Mansfield Amendment [1971-1972][1 of 3], Box 824.

[11] "Conversation Among President Nixon, the Chairman of the Federal Reserve System Board of Governors (Burns), the Director of the Office of Management and Budget (Ash), the Chairman of the Council of Economic Advisers (Stein), Secretary of the Treasury Shultz, and the Under Secretary of the Treasury for Monetary Affairs (Volker)," March 3, 1973, *Foreign Relations of the United States* (*FRUS*)*, 1969-1976, Vol. 31, Foreign Economic Policy, 1973-1976*, doc.16. In his memoirs, Secretary of the Treasury John A. Connally wrote, "State has the glamour, Defense has the toys, but Treasury is…the most powerful job in the cabinet." Some would disagree (Kissinger remained the most influential foreign policy adviser in the administration), but this sentiment rang more true during the Nixon administration after Connally's appointment than under Nixon's Cold war-era predecessors.

[12] The literature on the relaunch of the European integration in December 1969 at The Hague Summit tends to emphasize regional factors including the growing strength of West Germany, the debate over British entry, and changes of leadership in France and West Germany in 1969. For a sample of the existing literature that stresses the issues listed above, see Andrew Moravcik, T*he Choice for Europe: Social Purpose & State Power From Messina to Maastricht* (Ithaca, NY: Cornell University Press, 1998); Daniel Möckli, *European Foreign Policy During the Cold War: Heath, Brandt, Pompidou, and the Dream of Political Unity* (London: I.B. Tauris, 2009). In contrast, this chapter argues that exogenous factors – chiefly the rise of financial globalization and U.S. monetary policy – greatly affected the timing and constitution of economic and monetary union that the Western Europeans pursued after December 1969. It comports with a body of work that sees U.S. policy as playing a decisive issue, but tends to ignore the importance of the Euromarket. See, for example, John Gillingham, *European Integration, 1950-2003: Superstate or New Market Economy?* (New York: Cambridge University Press, 2003); and C. Randall Henning, "Systemic Conflict and Regional Monetary Integration: The Case of Europe," *International Organization* 53, no. 3 (Summer 1998): 537-73.

Werner Report in October 1970 and the "Snake in the Smithsonian Tunnel" in April 1972 were undermined, however, by assaults on currencies within the Community. Countries such as West Germany and Britain valued taking steps toward monetary and economic integration, but they decided during currency crisis that the need to limit the harmful effects of hot money on their domestic economies took priority.

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Bretton Woods emerged from the economic and political context of the Second World War. As the war raged across Europe and the Pacific, delegates from 44 countries met in June and July 1944 in Bretton Woods, New Hampshire to conceive a postwar international system. The lessons of the 1930s weighed heavily on the minds of policymakers. During the Great Depression, the great powers–capitalist and socialist alike–pursued mercantilist trade policies, and the world dissolved into rival trade blocs, constraining the flow of trade and capital.[13] Policymakers at Bretton Woods stressed the need to avoid a repeat of those harmful autarkic policies and competitive currency devaluations, and emphasized the importance of multilateralism. They sought to encourage international trade while providing governments with the flexibility to make domestic policy without fear of having to take painful measures to resolve deficits in their balance of payments. Government appeared in the early 1940s as the economic guarantor of its citizens, and delegates wanted to protect this emerging "welfare state." They considered politically unacceptable the reestablishment of the gold exchange standard that had existed since the end of the nineteenth century in which the national gold stock determined the

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[13] Oscar Sanchez-Sibony makes the provocative argument that the Soviet Union should be included in a study of this movement. See *Red Globalization: The Political Economy of the Soviet Cold War from Stalin to Khrushchev* (Cambridge: Cambridge University Press, 2014), especially 25-56.

domestic money supply and price levels; such a system could not work in an age when governments promised full employment and spent liberally on social programs.

Led by John Maynard Keynes and Harry Dexter White, the delegations developed a compromise between British and U.S. priorities that would allow these international and domestic priorities to coexist. At the center of the system lay the creation of the International Monetary Fund (IMF). The IMF managed the balance of payments by overseeing a system of fixed exchange rates based on the U.S. dollar that could fluctuate slightly by one percent in either direction.[14] Rather than force countries to deflate and implement austerity measures to correct deficits, the IMF would lend money to governments to finance their debts. The governments would then have three to five years to repay their loans from the IMF. This allowed states to engage in deficit spending and provide social services to their populations. Each country received a quota to fund the IMF, and it had to supply a quarter of its quota in gold and the remaining three-quarters in its own currency. In addition, the International Bank for Reconstruction and Development, later known as the World Bank, was charged with the role of assisting the construction of Europe's devastated economies. Concluded in 1947, the General Agreement on Trade and Tariffs (GATT) established the Most Favored Nation (MFN) norm that liberalized international commerce. As the central currency, the U.S. dollar remained convertible into gold at the price of $35 per ounce, expanding the supply of reserve assets.[15] The fixed price of the U.S. dollar to gold provided stability and confidence to the system, and the leading role of the U.S. dollar demonstrated American ascendancy in international economics. The IMF allowed member countries to restrict the convertibility of their currencies until they had recovered from

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[14] A country could devalue or revalue its currency in the case of a "fundamental disequilibrium" in its balance of payments by 10 percent unilaterally, but a larger change required IMF approval.
[15] The price of gold at $35 an ounce had existed since 1934.

the war, and it was only in late December 1958 that all major European currencies had become freely convertible.[16]

During the 1950s and the 1960s, the West experienced an unprecedented two decades of prosperity. The Second World War devastated the economies of East Asia and Western Europe, but the recovery proceeded remarkably quickly. Virtually free from military expenditures, Japan concentrated on developing its domestic economy, and its gross national production (GNP) rose more than 10 percent every year from the mid 1950s through the 1960s.[17] It found success in an export-driven economy, particularly through its exports to the United States. In 1950, Japan's GNP totaled $11 billion; by 1973, it had climbed to $320 billion–a thirteen-fold increase.[18] Similarly, the Western Europeans managed to reach their prewar levels of industrial production by 1947 and 1948, and American aid through the Marshall Plan accelerated growth. The Marshall Plan did not save Europe, but it provided necessary capital to boost economic activity and investment in the welfare state.[19] Industrial production in West Germany and Italy tripled from 1949 to 1963 with that of France close behind.[20] The creation of the European Economic Community in 1958 liberalized trade within Western Europe, providing a large internal market

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[16] With the exception of Czechoslovakia, none of the socialist countries of Eastern Europe joined. Czechoslovakia withdrew from the Bretton Woods system in 1949.
[17] Michael Schaller, "Japan and the Cold War, 1960-1991," in *The Cambridge History of the Cold War: Volume III, Endings*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), 162.
[18] Andrew Gordon, *A Modern History of Japan: From Tokugawa Times to the Present, 2nd Edition* (New York: Oxford University Press, 2009), 244. On the success of Japan's economy in the postwar period, see Andrew Gordon, *The Wages of Affluence: Labor and Management in Postwar Japan* (Cambridge, MA: Harvard University Press, 1998); John Price, *Japan Works: Power and Paradox in Postwar Industrial Relations* (Ithaca, NY: Cornell University Press, 1997); and Takafusa Nakamura, *The Postwar Japanese Economy: Its Development and Structure* (Tokyo: University of Tokyo Press, 1981)
[19] The literature on European postwar reconstruction is vast. The authoritative work remains Alan S. Milward, *The Reconstruction of Western Europe 1945-1951* (Berkeley and Los Angeles, CA: University of California Press, 1984. For a survey of the literature, see the corresponding bibliography to William I. Hitchcock's chapter "The Marshall Plan and the Creation of the West," 521-23.
[20] William I. Hitchcock, *The Struggle for Europe: The Turbulent History of a Divided Continent, 1945 to the Present* New York: Anchor Books, 2003), 131.

that boosted production. Overall, the combined gross domestic product (GDP) of all nations almost tripled from the end of the Second World War to 1973.[21]

The world economy experienced impressive growth, but the system lacked a mechanism to rectify chronic imbalances. The stability of the fixed exchange rates could only be maintained by increasing liquidity, a process that allowed the U.S. to export its debts but ultimately undermined confidence in the system. As Gavin concludes, "the Bretton Woods system started breaking down as soon as it really began to function" in late 1958.[22]

Two structural problems plagued Bretton Woods. First, the United States consistently ran deficits in its balance of payments. The U.S. economy increasingly became a service-oriented economy–in 1950, the national output was 30 percent in services, but that number grew to 42 percent by 1971. Consumer appetite led to an increase in imports and the country bought an increasing share of its raw materials (including energy, iron ore, copper, natural rubber, tin, nickel, and others) on the world market. The U.S. ran its first trade deficit since 1893 in 1971.[23] In the 1960s, President Lyndon B. Johnson escalated two wars: one in the Vietnam against communism, and the other at home against poverty. Military expenses in Southeast Asia skyrocketed after the Americanization of the war. During the fiscal year 1965, the cost of fighting the war totaled $100 million. Johnson's August 1965 and January 1966 requests, however, came in at $14 billion. Afraid of the placing the economic burden of the Vietnam War and the Great Society onto the American taxpayer, Johnson refused to raise taxes. He proposed a

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[21] Tim Borstelmann, *The 1970s: A New Global History From Civil Rights to Economic Inequality* (Princeton, NJ: Princeton University Press, 2012), 53.

[22] Gavin, *Gold, Dollars, and Power*, 21, 199-200. This chapter builds on the framework that Gavin establishes by internationalizing the crises and paying more attention to the Nixon administration. Although Gavin includes a brief chapter on Nixon, the focus of his work is on the Johnson administration.

[23] Peter G. Peterson, "A Foreign Economic Perspective," December 27, 1971, GFPL, Arthur Burns Papers, 1969-78, Federal Reserve Board Subject File, CIEP: "A Foreign Economic Perspective" by Peter G. Peterson 12/27/71, Box B24.

six percent income tax surcharge at the beginning of 1967, but quickly withdrew when economic growth slowed.[24] By the mid 1960s, U.S. current account surpluses no longer balanced investment outflows and military spending overseas.[25]

The unsustainable deficits in the U.S. balance of payments led to a "dollar overhang" in which the accumulation of dollars overseas exceeded the value of the gold reserves that the United States held in Fort Knox, Tennessee.[26] At the end of the Second World War, the U.S. had a preponderant economic position and held 70 percent of the world's gold supply, but the rapid recovery of the Japanese and Western European economies caused American reserves to decline over the next two decades.[27] By 1965, the "dollar overhang" became a reality. Bretton Woods only worked if holders of dollars believed that the "dollar was as good as gold."

Some allies, notably West Germany and Japan, agreed to hold dollars as a reserve asset as a *quid pro quo* for their places under the U.S. military umbrella, but France proved less willing.[28] Paris resented the central role of the United States in the global economy (as well as in

[24] Kunz, *Butter and Guns*, 111.
[25] Sargent, *A Superpower Transformed*, 103.
[26] This problem became known as the "Triffin Dilemma." In 1960, Belgian-American economist Robert Triffin warned that Bretton Woods contained an inherent contradiction. The increase of trade demanded holding U.S. dollars as reserves. The dollars in circulation would come to surpass the value of U.S.-held gold, making the convertibility of dollars into gold at $35 an ounce impossible. See Triffin, *Gold and the Dollar Crisis* (New Haven, CT: Yale University, 1960).
[27] Keith Pilbeam, *International Finance, 2nd Edition* (London: MacMillan Press, 1998), 279.
[28] The president of the Bundesbank Karl Blessing promised in March 1967 that the FRG would refrain from converting its dollars into gold. Blessing wrote to Federal Reserve chairman William M. Martin, "You are, of course, well aware of the fact that the Bundesbank over the past few years has not converted any of the dollars accruing out of German foreign exchange surpluses into gold from the United States Treasury. The increases in our gold reserves over these years came about mostly through gold sales of the IMF in connection with the DM purchases for the British drawings in the IMF and through our participation in the Central Banks' Gold Pool. By refraining from dollar conversions into gold from the United States Treasury, the Bundesbank has intended to contribute to international monetary cooperation and to avoid any disturbing effects on the foreign exchange and gold markets. You may be assured that the Bundesbank intends to continue this policy and to play its full part in contributing to international monetary cooperation." Karl Blessing to William M. Martin, March 30, 1967, Deutsche Bundesbank online archive,
https://www.bundesbank.de/Redaktion/DE/Downloads/Bundesbank/Wissenswert/schreiben_gold_blessing_brief.pdf?__blob=publicationFile.

European international affairs) and called for a return to the gold exchange standard.[29] At a press conference in February 1965, French President Charles de Gaulle identified the problem of the current system. The Americans pay their liabilities, he said, "in dollars that they themselves can issue as they wish, instead of paying them totally in gold, which has a real value, and which one possesses only if one has earned it."[30] This charge gained traction as the U.S. involvement in the Vietnam War escalated, and critics accused Washington of financing its war at the Europeans' expense.[31]

The second issue was the rise of the offshore Euromarket based in London that created an arena for trading dollars that fell outside of the control of U.S. authorities. Eurodollars were dollar denominated short-term assets held outside of the United States, primarily owned by non-U.S. residents. The Euromarket was created in the 1950s to hold the dollar-denominated funds of socialist countries that were unwilling to hold them in the United States, but soon became the area of choice for multinational companies to "park" their growing assets.[32] The John F. Kennedy administration introduced capital controls to defend the dollar, hoping to discourage the issuance of foreign bonds in the United States. Multinational businesses tended to place their profits into the Euromarket because they could receive better interest rates than in the United

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[29] Daniel J. Sargent, "Lyndon Johnson and the Challenges of Economic Globalization," in *Beyond the Cold War*, 25-28.

[30] Jean Lacouture, *De Gaulle: The Ruler 1945-1970*, tr. By Alan Sheridan (New York: W.W. Norton, 1993), 381. Gavin believes that de Gaulle's primary motivation was that the deficit dollars would allow American businesses to take over European companies cheaply. If this happened, the French president feared, the Europeans would lose their independence. He said, "Western Europe has become, without being aware of it, a protectorate of America. It is now a question of ridding ourselves of its domination." Gavin, *Gold, Dollars, and Power*, 121.

[31] Seeking to decrease the system's dependence on gold, Johnson proposed the creation of a new reserve asset allocated based on gold and currency holdings: special drawing rights (SDRs). As the dollar overhang increased, confidence in the dollar decreased.

[32] Giovanni Arrighi, "The World Economy and the Cold War, 1970-1990," in *The Cambridge History of the Cold War: Volume III, Endings*, 28. On the rise of multinational companies, see Vernie Oliveiro, "The United States, Multinational Enterprises, and the Politics of Globalization," in *The Shock of the Global*, 143-55. On the structure of the Euromarket, see Geoffrey Bell, *The Euro-dollar Market and the International Financial System* (New York: John Wiley & Sons, 1973); and Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca, NY: Cornell Univeristy Press, 1994), 81-100.

States and they could also avoid the Kennedy administration's capital controls.[33] After the explosion of the Euromarket in the mid 1960s, the U.S. government lost control of a significant percentage of its money supply–the dollars held in the Euromarket rose as a percentage of the U.S. monetary supply from 9.65 percent in 1967 to 34.47 percent in 1972.[34]

The Bretton Woods system sought to provide governments with autonomy over their nation's monetary policy while still promoting international trade, but the rise of the Euromarket disrupted this precarious compromise. In 1969, the IMF acknowledged that "the liberalization of capital transactions in the last ten years has been a major factor tending toward an integrated world economy. But it has brought with it the greatly increased possibility of sudden pressures on exchange rates, notably when underlying economic developments give reason to suppose that an adjustment may occur."[35] Governments tended to shy away from making quick and decisive use of the IMF adjustment process, and speculators saw opportunities to make profits or to prevent losses in currencies that they believed over- or undervalued. Real economic concerns drove capital flows, and international speculators reacted to trade and budget data.

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Financial globalization precipitated a series of speculative assaults on currencies, threatening the fixed exchange rate system that underpinned Bretton Woods. The first major blow came in November 1967 with the devaluation of the pound. Sterling had long been considered the weakest link of Bretton Woods because of the British balance of payments deficits. The political commitment of the British government to full employment compounded its weak trade position as Whitehall pursued expansive fiscal policies even in the appearance of

[33] Sargent, *A Superpower Transformed*, 32.
[34] Sargent, "The Challenges of Economic Globalization," 28.
[35] See *International Monetary Fund Annual Report 1969*
http://www.imf.org/external/pubs/ft/ar/archive/pdf/ar1969.pdf.

severe deficits that reached a height of about £3 billion by 1964. The government refused to devalue and the international community, notably the United States, hesitated to place pressure on London to force the issue. Washington sought close political ties with London as it waged an unpopular war in Vietnam and also considered the pound to be the first line of defense of the dollar; if sterling fell to speculation, many U.S. officials believed that the dollar would face a similar onslaught.[36] Immediately upon entering office in October 1964, the new Labour government under Harold Wilson faced a sterling crisis and had a politically advantageous opportunity to devalued the pound and blame the economic problems on the outgoing Conservative government. Wilson's decision, however, to impose a 15 percent import surcharge and arrangement of a $3 billion bailout from an international consortium merely delayed the inevitable.[37] Although the U.K. halved its deficit between 1964 and 1965 and continued to make progress in 1966, domestic and exogenous events placed London in a precarious position. In particular, the breakout of the Liverpool dock strikes and the closure of the Suez Canal during the Arab-Israeli War squeezed British exports.[38] In November 1967, a renewed run on sterling occurred as uneasy investors sought refuge in the strong D-mark, and the British yielded to the speculative pressure by devaluing the pound just over 14 percent, believing that the measure would help correct the deficit in the balance of payments. In his memoirs, Wilson remembered the "suddenness with which we had been overwhelmed by the operations of a speculative market."[39]

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[36] Thomas A. Schwartz, *Lyndon Johnson and Europe: In the Shadow of Vietnam*, 66.
[37] Gavin, *Gold, Dollars, and Power*, 167.
[38] James, *International Monetary Cooperation After Bretton Woods*, 183-91.
[39] Harold Wilson, *The Labour Government 1964-1970: A Personal Record* (London: Weidenfeld and Nicolson, 1971), 460.

Speculators then turned to the United States. “The storm broke,” as scholar David Calleo describes, in February 1968 after learning that the U.S. deficit reached $3.7 billion in 1967, and capital fled the United States. In addition, U.S. involvement in the Vietnam War undermined the confidence in the dollar in the eyes of speculators; General William Westmoreland recently asked for yet another escalation of American military operations in the war-torn country, and there was no end to the war on the horizon.[40] Johnson’s senior advisers proposed the closure of the London gold market to prevent further outflows of the U.S. gold reserves (the U.S. lost $372 million on March 14, and the White House projected a loss of $1 billion the following day) and avoid a rise in the official price of gold.[41] The Americans shared with the British and French their request “that, just as the United States Government had acted responsibly during the years of the dollar gap, so now they [USG] now hoped for a responsible attitude on the part of the surplus countries.”[42] At a conference in Washington from March 16-17, Secretary of the Treasury Henry Fowler convinced seven representatives of foreign central banks and the director of the IMF of the prudence of the U.S. proposal. From this point, there was a “two-tier gold system.” Under this new regime, Washington agreed to continue selling gold at the prevailing rate of $35 per ounce to other central banks, but no longer would governments buy gold on the free market. Instead, they would activate SDRs and rely on them for reserves. There would be a separate market on which private parties could purchase gold for a floating price.[43] This policy,

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[40] David Calleo, *The Imperious Economy* (Cambridge, MA: Harvard University Press, 1982), 56-58.
[41] “Memorandum From the President’s Special Assistant (Rostow) to President Johnson,” March 14, 1968, *FRUS, 1964-1968, Volume VIII, International Monetary and Trade Policy*, doc. 189.
[42] Patrick Reilly (Paris) to FCO, “United States Economic Measures,” January 8, 1968, UKNA, FCO 59/194.
[43] Lyndon B. Johnson, *The Vantage Point: Perspectives of the Presidency 1963-1969* (New York: Holdt, Rinehart and Winston, 1971), 318-19.

Sargent argues, represented a "last-ditch effort to insulate a state-centric international monetary order from the march of financial globalization."[44]

Speculators next turned to France and West Germany, attracted by the weak franc and strong D-mark. During the 1960s, France enjoyed surpluses but in 1968, French fortunes changed. French Ambassador to London Geoffroy de Courcel shared with the British Chancellor of the Exchequer that the French economic outlook was precarious: unemployment was fairly high with no relief in sight, consumption was low, and there existed a great deal of unused industrial capacity. To make matters worse, the industrial upheaval of May 1968 brought France close to revolution and eventually increased the cost of labor. As a result, confidence in the franc decreased and capital fled the country. France ended 1968 with a deficit of $3.5 billion.[45] The West Germans, however, experienced just the opposite. Unique among the industrial democracies, the FRG had export-led economic growth without inflation. Incited by expectations of a D-mark revaluation, speculators poured money into the country in the late summer and fall of 1968, including $2.15 billion during the first three weeks of November.[46]

European officials disagreed on how to handle the situation. The French did not want to devalue, believing it politically unfeasible and economically unnecessary. Director of the Treasury René Larre intimated that Paris wanted the West Germans to revalue the D-mark and thought that drawing out the process only drained French reserves.[47] Their position was largely

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[44] Sargent, "The Challenges of Economic Globalization," 33. Virtually all nations adhered to this agreement – the lone exceptions included Portugal and the Congo, which purchased gold from the South African Reserve Bank. On U.S. concern about South African gold, see "Notes on International Financial Policy Discussion: Gold," May 16-17, 1969, NARA, RG 56, OASIA, FLW, FLWidman Chron. – May 1969, Box 3. For a very good overview of the crisis, see "Treasury Historical Memorandum No. 20: The Gold Crisis, March 1968," January 1975, UKNA, T 267/21.
[45] Treasury Historical Memorandum No. 30, "The Collapse of the Bretton Woods System 1968-1973," October 1976, UKNA, T 267/36.
[46] Gray, "'Number One in Europe': The Startling Emergence of the Deutsche Mark, 1968-1969," 56.
[47] "Telegram From the Embassy in Belgium to the White House," November 15, 1968, *FRUS, 1964-1968, Vol. VIII: International Monetary and Trade Policy*, doc. 206.

shared by the British and Americans, whose exports would also benefit from a revaluation of the D-mark. In contrast, the West Germans were incredulous at the suggestion that the weight of adjustment should fall on Bonn. West German Economics Minister Karl Schiller argued that West Germany, "which had achieved price stability with a growth rate of 6 per cent and a satisfactory labour situation through responsible Trade Union co-operation, should not be expected to take the full burden."[48] Bonn recognized that the countries with deficits–not just France, but also Britain and the United States–would welcome West German revaluation,

At Fowler's request and with British support, Schiller agreed to call an emergency session of the Group of 10 in Bonn.[49] Hoping to avoid being forced into a corner by the international community, Schiller announced reductions of import and export taxes by four percent. This promised to decrease the West German surplus while providing Bonn with flexibility to stop the measures if its exports decreased too rapidly. Wilson dismissed these measures, complaining to the West German ambassador in London that the import-export taxes would not "change anything fundamentally" and were "irresponsible."[50] Despite the concerted efforts of the U.S., British, and French, the West Germans resisted pressure to revalue. Schiller told his counterparts that the West Germans had decided firmly against revaluation. The four percent tax measures, he declared, were equivalent to a revaluation and would reduce West German surplus by a third. The British and Americans disputed this, and agreed that a minimum of a 7.5 percent revaluation was necessary. Schiller was unmoved. The British embassy in Bonn reported that West "German obstinacy, and Schiller's tactics and personality, have made it an

[48] "Record of a Meeting held on 20 November, 1968, between The Chancellor of the Exchequer, The Right Honourable Roy Jenkins, M.P., and the Federal German Minister of Economics, Dr. Karl Schiller," UKNA, FCO 59/456.
[49] "Deutsche-amerikansiche Regierungsbesprechung," 18. November 1968, *AAPD 1968, Bd. III*, dok. 383.
[50] "Botschafter Blankenhorn, London, an Bundesminister Brandt," 20. November 1968, *AAPD 1968, Bd. 3*, dok. 385.

extremely trying experience for all of us," but the international press hailed the conference as a coming out moment for West Germany.[51] Newspapers around the industrial democracies ran articles that commended criticized the others for unfairly seeking to punish Bonn for its success. The West German public also applauded Schiller's strong stand. They resented international pressure to revalue, and protestors held signs that read "Wilson: Hands Off Our D-Mark." Echoing this sentiment, Chancellor Kurt Georg Kiesinger publicly pledged on November 22: "As long as I am chancellor, the German mark will not be revalued."[52]

The public West German stance against revaluation calmed the markets briefly, but the structural problems of the French deficit and West German surplus persisted. The spark for a renewed crisis came in late April 1969 with the resignation of French President Charles de Gaulle, who had long refused to consider devaluing the franc as a matter of prestige. The French election precipitated a run on the franc as speculators watched to see the new French government's stance on devaluation. As William Glenn Gray contends, "The constellation of November 1968 returned [in spring 1969] with a vengeance, as the combination of French weakness and German robustness opened the prospect of serious speculative gains [or losses] following a currency realignment."[53] Between April 28 and May 9, about $4.1 billion poured into West Germany, including almost $3 billion between May 7 and May 9 alone.[54] About two-

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[51] Roger Jackling to Harold Wilson, undated (but likely November 22, 1968), UKNA, FCO 59/455. For a British summary of the conversations from November 20-22, 1968 in Bonn and the buildup to the conference, see Treasury Paper, "The Bonn Conference: November 1968," UKNA, FCO 59/455. For the West German evaluation of the conference, see "Aufzeichnung des Ministerialdirigenten Berger," 25. November 1968, *AAPD 1968, Bd. 3*, dok. 389.

[52] Gray, "Number One in Europe," 68. For the official summary of the Bonn conference, see "Communique of the Ministers and Governors of the Group of Ten Meeting in Bonn 20 Through 22 November 1968," UKNA FCO 59/455.

[53] Gray, "Number One in Europe," 71-72.

[54] $4 billion constituted about a quarter of the entire West German money supply.

thirds of the money came from the United States and dollars from Euromarket.[55] For a country "with an ambitious goal of stability such as the Federal Republic," an FRG Ministry of Economics staffer wrote, the capital movement portended instability.[56] Speculators believed that the revaluation of the D-mark was "just a matter of time."[57]

The situation publicly pitted Schiller against Minister of Finance Franz-Josef Strauss as revaluation became a divisive party issue. On one hand, Schiller of the Social Democratic Party (SPD) argued in favor of a revaluation of the D-mark of 6.25 percent. With the support of the Bundesbank and the business community, the minister of economics stressed the importance of combatting inflation, pointing in particular to the increase in the prices of agricultural products and housing.[58] On the other hand, Strauss' Christian Social Union (CSU)–whose base of support was among farmers in Bavaria–opposed revaluation because of its troubling implications for agricultural exports. He stated his willingness to consider revaluation, but only in the event that FRG did so with corresponding devaluations in France and Britain. Kiesinger supported Strauss, seeking to honor his public commitment from November 1968 that the D-mark would not be revalued as long as he was in power. Strauss and Kiesinger also had the public on their side; a public opinion survey revealed that 87 percent of West Germans opposed revaluation because it would hurt exports.[59]

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[55] NSC staffer Richard N. Cooper warned Kissinger that the emerging monetary crisis threatened a drain on the U.S. gold stock. Although West Germany could not convert its dollar inflows into gold (because of an existing agreement), the crisis could compel other Central European states with strong currencies (Switzerland, for example) to cash in their dollars. If this were to occur, Cooper strongly advised that slam the gold window shut. This would anger the Western Europeans and lead to bad press for the president, but "there is not much Europeans or others could do about it." Richard N. Cooper to Kissinger, "Implications of Gold Suspension and a Floating Pound," May 2, 1969, RNPL, NSC Files, Subject Files, Balance of Payments [Jan '69 – Feb '72], Box 309.
[56] "Referat VI B 6, "Spielregeln der Wechselkurspolitik," 19. März 1969, Bundesarchiv-Koblenz (BAK), Koblenz, Germany, B 102/84134.
[57] "Nervosität an den Devisenmärkten wächst Heißes Auslandsgeld geht in die D-Mark," 2. Mai 1969, *Die Welt*, s. 13.
[58] Karl Schiller, "Kabinettsvorlage: Antrag auf Verbesserung der Währungsparität der Deutschen Mark um 6,25% (1 Dollar=3,75 DM)," May 9, 1969, PA-AA, B 52 (Referat IIIA1), Bd. 587.
[59] "Germans Split on Currency," May 9, 1969, *Washington Post*, p. A1.

During an intense Cabinet debate on May 9, Schiller argued that under the *Stabilitäts- und Wachstumsgesetz*, Bonn was required to take measures in the event that its economic equilibrium was endangered. The hot money rushing into the country threatened internal price stability, and only revaluation could save the country from an increasing cost of living. Kiesinger rejected this argument, contending that the Cabinet needed to take into account the political consequences of revaluation. He also doubtlessly believed that he should not take such a drastic step with the federal elections approaching in September. That evening, Kiesinger announced that West Germany would not change the value of the D-mark.[60] Kiesinger expected a replay of the situation of November 1968 in which capital retreated from West Germany after speculators learned of Bonn's decision. Government spokesman Conrad Ahlers described Kiesinger's decision as "final, unequivocal and for eternity." When reporters pressed Ahlers if West Germany would reconsider in the event that its allies offered to participate in a general realignment of currency parities, the spokesman responded that no external factors would change this decision.[61]

In France, Georges Pompidou won the presidency and took office on June 20, 1969. The new French government announced measures to combat inflation, including the freezing of a large number of public investment programs. The drain on the reserves, however, continued. On August 8, 1969, the French announced a devaluation of the franc by 11.1 percent. The devaluation, the French hoped, would provide them with a relief from imports and increase

[60] "Sondersitzung am 9. Mai 1969: Währungspolitische Lage," Kabinettsprotokolle 1969, Die Kabinettsprotokolle der Bundesregierung online, http://www.bundesarchiv.de/cocoon/barch/0001/k/k1969k/kap1_2/kap2_9/para3_1.html

[61] David Binder, "Bonn Rules Out Increasing Value of German Mark," May 10, 1969, *NYT*, p. 1. French Ministry of Finance staffer Jacques de Larosière believed "the way the Germans had behaved was quite extraordinary." Although Larosière understood that the FRG did not want to revalue with its upcoming election, he doubted whether the West Germans genuinely wanted to come to a bilateral arrangement because if they had, Bonn would have made a private overture to Paris. J. Anson to J.F. Slater, May 13, 1969, UKNA, FCO 59/469.

international confidence in the franc. Pompidou was the main force behind the decision; he believed that if he devalued the franc shortly after taking office, he could blame the French currency's struggles on the departing de Gaulle government. The French devaluation calmed the market for a few weeks.

Despite Kiesinger's and Ahler's declarations that West Germany would not revalue the D-mark, the pressure on the currency increased as the West German federal elections approached. In December 1966, Kiesinger had taken power in a Grand Coalition between the Christian Democratic Union/Christian Social Union (CDU/CSU) and Social Democratic Party (SPD). The revaluation question became a central issue of the election cycle as speculators anticipated an SPD victory that would empower Schiller (SPD) to control West German monetary policy. Between September 22 and September 24, about DM 2.5 billion poured into West Germany. In order to stop the flow of hot money into the country, Kiesinger ordered that the West German foreign exchange market close.[62] At a cabinet meeting on September 29, the government accepted Emminger's recommendation that the D-mark should float on the free market.[63] This served as a compromise between the positions of Strauss and Schiller; it left open the (very slim) possibility that the D-mark would return to its original exchange rate after floating, while also providing an opportunity for the currency to settle at a higher value. In particular, this suited Schiller, who had come to support the "crawling peg" strategy in which the

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[62] Abteilung VI, "Währungspolitische Situation nach den Beschlüssen der Bundesregierung vom 29.9.1969," October 3, 1969, BAK, B 102/84096.

[63] Emminger's idea represented a departure from an earlier proposal. In June 1969, he told a group of economic experts at the University of Cologne that "we should look for an adjustment method which, if necessary, allows for a gradual change in the relationship between the D-mark and dollar that creates as little disturbance [in the international system] as possible." Emminger believed that allowing the D-mark to increase slightly in relation to the dollar would eliminate some uncertainty in trade and capital movements.
"Die Stellung der DMark im internationalen Währungssystem: Ausführungen von Dr. Otmar Emminger, Mitglied des Direktoriums der Deutschen Bundesbank, vor dem Institut für Bankwirtshaft und Bankrecht an der Universität Köln am 12. Juni 1969," BAK, B 136/3335.

government retained some autonomy to gradually change the par value of its currency.[64] Schiller later told U.S. Secretary of the Treasury David M. Kennedy that "Strauss had not realized that once the deutschemark began to float, it would be impossible to return to the old parity. Strauss still feels that he was tricked on this point."[65] The D-mark ultimately appreciated by 9.3 percent when the West German Cabinet finally fixed its currency to the dollar on October 27.[66]

The changes in the par values of the franc and D-mark in the fall of 1969 brought an end to an extraordinarily tense and uncertain period of two years in the history of Bretton Woods. The pound–which American officials believed to be the first line of defense for the dollar–had broken ranks, and the franc and D-mark floated as well. These crises indicated the growing power of transnational capital to disrupt the system of fixed exchange rates. Policymakers did not want to break from Bretton Woods, but the fear of inflation and the loss of valuable reserve assets forced them to seek temporary refuge from the speculators through floating.

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As the international monetary system lurched from one crisis to the next, debates raged about how to reform the international monetary system, and prevent the pressure of financial globalization from unraveling Bretton Woods and dividing the industrial world into autarkic trade blocs. In the United States, the Nixon administration grappled with conflicting objectives. On one hand, Nixon and the diplomatic elements of the administration wanted to prioritize the

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[64] Gruppe III/1 an Kiesinger, "Internationales Währungssystem," July 16, 1969, BAK, B 136/3336.
[65] "Memorandum of Conversation: Germany and United States," December 17, 1969, NARA, RG 56, OASIA, FLW, FLWidman Chron. – December 69, Box 3.
[66] The new government was controlled by a coalition between the SPD and Free Democratic Party (FDP) under Chancellor Willy Brandt. Although Kiesinger won a plurality of the vote, Brandt broke from the Grand Coalition to form a coalition with the FDP. FDP chairman Walter Scheel became vice chancellor. For Schiller's public explanation on the government's decision, see BMWi Tagesnachrichten, "Bundeswirtschaftsminister Schiller zur Aufwertung der DM," October 28, 1969, BAK, B 102/84097. In March 1970, the Agricultural Committee of the Bundestag agreed on a government bill that provided DM 920 million to farmers that offset the resulting losses from the revaluation of the DM. Bonn to State, "Compensation to Farmers for Losses from DM Revaluation," March 20, 1970, NARA, RG 59, Subject Numerical Files, 1970-73, Economic, FN 17 GER W 1/1/70, Box 886.

U.S. military presence in Europe. Nixon assigned great importance to areas of the world such as Asia and the Middle East, but he stressed that "NATO was the blue chip." As a freshman Congressman in the late 1940s, Nixon remembered that he identified three justifications for the Atlantic Alliance: the threat from the Soviet Union, the weakness of Western Europe, and the need to contain German power. During his presidency, détente and the rise of the strength of the Community decreased the importance of the first two reasons, but the German Question still had not been resolved. Particularly in the fluid context of Brandt's *Ostpolitik*, NATO alone had the ability to anchor West Germany from venturing too far in its quest for reconciliation with the East. Nixon sought to bring the soldiers home from Europe, but he also believed that he could only do so with a reciprocal action from the Kremlin; a unilateral reduction of U.S. strength in Europe would be a symbol of weakness and simply out of the question.[67]

On the other hand, the United States had to rectify its deficit. Few in the administration wanted to withdraw from Europe, but the economic departments of the government pointed to the drain that the U.S. military presence had on U.S. resources. As Under Secretary of the Treasury for International Monetary Affairs Paul Volcker told an unconvinced Kissinger, "There are two separate questions: our desire to stay in Europe and our ability to sustain that position."[68] The United States spent about $1.8 billion per year to maintain its presence in Europe and the Mediterranean ($1 billion for official expenditures and $800 million for personal spending by

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[67] "Memorandum for the Record: The President's Meeting with Former High Government Officials and Military Officers on the Mansfield Amendment," May 24, 1971, RNPL, NSC Files, Name Files, Mansfield Amendment [1971-1972][1 of 3], Box 824.

[68] Kissinger scoffed at the idea of linking foreign policy priorities with economic limitations, saying "We are not going to give up our whole post-war foreign policy." He feared that if the United States withdrew, Western Europe would seek nuclear autonomy or move toward Finlandization. Both quotations are located in the transcript of "Legislative Interdepartmental Group: Mansfield Resolution," May 12, 1971, RNPL, NSC Files, Name Files, Mansfield Amendment [1971-1972][1 of 3], Box 824. On the link between the deployment of U.S. soldiers in Europe and the balance of payments during the 1950s and 1960s, see Gavin, *Gold, Dollars, and Power* and Marc Trachtenberg, *A Constructed Peace: The Making of the European Settlement 1945-1963* (Princeton, NJ: Princeton University Press, 1999).

military and civilian personnel and their families).[69] In addition, Nixon faced domestic political pressure from Congress– Democratic Senator Mike Mansfield perennially introduced a bill in Congress to withdraw U.S. troops unilaterally from Europe. In the context of the Vietnam War, the isolationist sentiment among the public grew. In addition to reducing the deficit, the Mansfield Amendment reflected "the historical nostalgia that sought to maintain America's moral values uncontaminated by exposure to calculations of power and the petty quarrels of shortsighted foreigners."[70]

The internal disagreements between the diplomatic and economic elements of the U.S. government were represented in a spring 1970 debate over National Security Study Memorandums (NSSM) 79 and 91. NSSM 79 explored the implications of the United Kingdom's accession to the Community, and NSSM 91 augmented NSSM 79 to include the preferential trade agreements of the Community.[71] Drafted by the State Department, the study supported continuing the two-decades old policy of supporting European integration. State argued that an integrated Western Europe could better mobilize its economic and human resources and participate in preserving the security of the North Atlantic area. In addition, it

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[69] Theodore L. Eliot, Jr. to Kissinger, "Material for Use in Discussion of Mansfield Amendment on US Forces in Europe," May 12, 1971, RNPL, NSC Files, Name Files, Mansfield Amendment [1971-1970][2 of 3], Box 824. Critics correctly pointed to the fact that offset agreements with West Germany minimized the total effect on U.S. balance of payments. NSC staffer C. Fred Bergsten fought against the suggestion of the chairman of the Council of Economic Advisers Paul McCracken and White House staffer Peter Flanigan that the United States should withdraw soldiers from Europe for balance of payments reasons. He penned a memorandum to Kissinger that described the "absurdity of possible reductions in U.S. forces overseas for balance of payments reasons." He acknowledged that the government spent a lot of money on its overseas military presence, but he scoffed at the notion that a reduction of forces would do anything significant to the balance of payments. Kissinger's deputy Alexander Haig wrote "Amen!" on the margins of the memorandum. C. Fred Bergsten to Henry Kissinger, "The Absurdity of Possible Reductions in U.S. Forces Overseas for Balance of Payments Reasons," December 3, 1970, NSC Files, SuF, Balance of Payments January 1969 to February 1972, Box 309, RNPL.
[70] Kissinger, *White House Years*, 939.
[71] Kissinger, "National Security Study Memorandum 79: U.K. Accession to European Community," October 13, 1969," RNPL, National Security Council Institutional Files, NSSM-79 [1 of 2], Box H-164; Kissinger, "National Security Study Memorandum 91: EC Preferential Trade Arrangements," March 27, 1970, RNPL, National Security Council Institutional Files, NSSM 91, Box H-207.

stressed the utility of the European integration as an anchor for West German power, allowing Bonn to participate as a full member of the international community without threatening its neighbors on either side of the Iron Curtain. State acknowledged that the growing power and tariff barriers of the Community posed a threat to U.S. exports, particularly in agriculture, but it believed that the reasons for previous administrations' support of European integration remained more compelling.[72]

The Departments of Treasury, Commerce, Agriculture, and the Special Trade Representative, however, did not concur with State's conclusions, and they jointly submitted a dissention. Unlike State, the economic departments saw the growth of Western Europe as a portentous development in world affairs. They contended that the expansion of the "European Community and its movement toward an economic and monetary union will result in a fundamental change in the basic world balance of international economic and financial power which will profoundly affect the prospects for both the industrial agricultural trade of the United States and third countries." The Europeans may seek to preserve their political and military partnership with the United States, but in the economic sphere, "past practice and current indications" suggest that the Europeans will look at the United States "as its principal competitor." The accession of four new states into the Community–Denmark, Ireland, Norway, and the United Kingdom–would extend the area of the Common Agricultural Policy, further threatening U.S. agricultural exports. The economic departments saw 1970 as a crucial moment when Washington's orientation toward Western Europe needed to change:

> Traditionally, the countries of Western Europe have given relatively high priority to economic self-interest. The United States, on the other hand, has for many years concentrated most of its attention on its political and military objectives, confident

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[72] Department of State, "NSSM 79 and 91: Enlargement of the European Community: Implications for the U.S. and Policy Options," April 23, 1970, RNPL, National Security Council Institutional Files, NSSM-79 [1 of 2], Box H-164.

> that its economic and financial interests would in large measure take care of themselves. In the enlarged EC, we will have a competitor large enough and strong enough to damage our interests seriously if we continue this practice. To ensure that the United states retains both the economic and financial ability and the domestic political support needed to protect our longer range political and defense interest we will in the future need to give higher priority to the defense of our economic and financial interest vis-à-vis the enlarged Community.

Although the economic departments acknowledged that U.S support for the enlargement of the Community stemmed from "compelling political reasons," they stressed that Washington must defend its economic interests and demand an end to barriers to U.S. trade and investment.[73]

Fearing the growing economic strength of the Common Market, the U.S. flirted with the idea of organizing a rival free-trade bloc to counter European protectionism. Possible members included the U.S., Britain, Canada, Australia, New Zealand, and Japan–or some combination thereof. The inchoate proposal posed many problems domestically and internationally, however, and no other country expressed interest in the suggestion. Each feared that the U.S. would dominate such an organization (although elements in the U.K. who opposed Community membership pushed the idea because they saw it as an opportunity to strengthen the "special relationship" with the United States and distance Britain from Europe).[74]

On the other side of the Atlantic, European policymakers identified the U.S. deficit as a serious impediment to the stabilization of the international monetary system, and they also worried about a repeat of the currency crises of 1968 and 1969. They turned to European integration as a means of sheltering themselves from the harmful effects of the U.S. deficit and financial globalization.[75] They harbored growing doubts about the reliability of future U.S.

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[73] "Statement by the Departments of Treasury, Commerce, Agriculture, and STR," April 22, 1970, NARA, RG 56, OASIA, FLW, FLWidman Chron. – April 1970, Box 4.

[74] C. Fred Bergsten to Henry A. Kissinger, "Alternatives to the Common Market – Your Request for My Views on a Possible Study," December 11, 1970, RNPL, NSC Files, Subject Files, European Common Market, Vol. 1, 1969-1970, Box 322.

[75] The development of a monetary union was not a new idea. In March 1964, for example, Giscard made a clandestine overture to Bonn to sound out West German interest in the idea. Benedik Schoenborn contends that

economic and political cooperation and turned inward to find stability. French Minister of Finance Valéry Giscard d'Estaing "could not stress too strongly" to Kennedy the Community's concern about "the U.S. inflation on their own economies, on confidence in the dollar, on the world monetary system, etc."[76] At Pompidou's request, the heads of state of the member-states of the Community met in early December 1969 at The Hague to discuss a future direction. Building on Brandt's initiative at the conference, the Community decided to embark on a path toward a monetary and economic union. The devaluation of the franc and revaluation of the D-mark created political conditions that allowed cooperation, breaking a stalemate that had plagued the Community in the late 1960s.[77]

The Council of Ministers commissioned an ad-hoc group in March 1970 under the chairmanship of Luxembourg Prime Minister and Finance Minister Pierre Werner to develop a blueprint for the achievement of an economic and monetary union. West Germany and France took the lead on Western European monetary integration, but they disagreed on how it should proceed. Four issues emerged as the central topics for decision. The Community needed to decide: first, whether to prioritize economic or monetary integration ("a typical chicken and egg problem"); second, whether they needed to introduce some degree of exchange rate flexibility to ease the adjustment process during the transition or whether the exchange rates should be locked

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Chancellor Ludwig Erhard's "non response" to this suggestion stemmed from the West German belief that giving a response to the French proposal represented a decision between Washington and Paris. See Schoenborn, "Chancellor Erhard's Silent Rejection of de Gaulle's Plans: The Example of Monetary Union," *Cold War History* 14, no. 3 (2014): 377-402. The idea of a monetary union can even be traced by to the Spaak Report of 1956.

[76] F. Lisle Widman, "Memorandum for the Files," December 12, 1969, NARA, RG 59, OASIA, FLW,

[77] "Parlamentarische Staatssekretärin Focket, Bundeskanzleramt, z.Z. Den Haag, an Bundesminister Ehmke," 2. Dezember 1969, *Akten zur Auswärtigen Politik der Bundesrepublik Deutschland (AAPD) 1969, Bd. II* (München: R. Oldenbourg Verlag, 2000), dok. 386. Other accomplishments of The Hague Summit included the removal of the CAP from control of the Parliament, a model for the European Council, and an agreement to consider British candidacy for membership. John Gillingham, *European Integration 1950-2003* (New York: Cambridge University Press, 2003), 82. For a copy of the conference communique, see "The Hague Summit: final communiqe of the meeting of heads of state or government of the EC countries," December 2, 1969, in *Documents on European Union*, ed. and tr. By A.G. Harryvan and J. Van der Harst (New York: St. Martin's Press, 1997), 168-69.

together by progressively narrower exchange rate margins; third, whether it would be necessary to transfer some national state responsibilities to Community institutions; and fourth, how to enlarge the Community without hindering progress toward the economic-monetary union.[78]

The West Germans emphasized the need to develop economic cooperation before addressing monetary integration. Countries that had surpluses, low inflation, and stronger currencies–known as the "economists"–urged that the Community achieve harmony of its national economic policies before moving toward monetary integration. Member states with deficits, inflation, and weaker currencies–the "monetarists"– instead gave priority to monetary integration. At a meeting of economic and finance ministers in February 1970, Schiller–a leader of the economists–outlined the West German proposal. Backed by the Dutch and (to a lesser extent) the Italians, he called for a step-by-step approach in which the Community needed to complete one before moving onto the next. In particular, he believed that the Community needed to synchronize prices across the region. Schiller wanted a "crawling peg relationship" for the Community with the rest of the world, but favored maintaining existing margins in European relations. This duality would allow the Europeans to adjust in the event of further disruptions stemming from the dollar. Finally, Schiller and his colleagues in Bonn believed it dangerous to pool European resources prematurely; it would lead to West Germany bailing out its weaker neighbors.[79]

As the leading monetarists, the French–with the support of the Belgians and Luxembourgers–pushed in the opposite direction: rapid advancement toward monetary

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[78] J. Robert Schaetzel (Brussels) to State, "EC Monetary Union: An Assessment of Plans and Prospects," May 15, 1970, NARA, RG 59, Subject Numeric Files, 1970-1973, Economic, FN 17 1/1/70, Box 834.

[79] For a summary of the February 1970 conference in Paris, see Referat IA1, "Stufenplan zur Verwirklichung der Wirtschafts- und Währungsunion," February 25, 1970, PA-AA, B 52 (Referat IIIA1), Bd. 589. On West German thinking in early 1970, see Michael Kreile, "The Search for a New Monetary System," in *The Strategic Triangle*, 161-65.

integration. Much of this stemmed from the French view that Washington's policy of "benign neglect" destabilized the system. "The outright hostility [under de Gaulle] is now diminished. But there remains resentment," the British Foreign Office observed. The French believed that the reserve status of the dollar and its fixed relationship to gold allowed the United States to "run deficits with impunity." Monetary integration, Paris believed, would reduce European reliance on the dollar.[80] Giscard pushed for a reduction of exchange rate margins for member currencies and opposed flexibility in the international monetary system. He wanted to maintain ironclad exchange rates that speculators would not dare attack, and capital controls that would stem the tide of capital flows. He also sought pooling of currency reserves that would alleviate French deficits.

Submitted in October 1970, the Werner Report provided a compromise between the economists and monetarists, proposing that the monetary and economic integrative processes develop simultaneously. It envisioned a monetary union in which there existed "inside its boundaries the total and irreversible convertibility of currencies, the elimination of margins of fluctuation in exchange rates, the irrevocable fixing of parity rates, and the complete liberation of movement of capital."[81] The report called for the harmonization of economic policies (as stipulated in Articles 104 and 105 of the Treaty of Rome), including an alignment in the system of the value-added tax and abolition of obstacles to capital movement. It also proposed the establishment of a medium-term facility (the French and West Germans disagreed on the amount that should be made available–Paris suggested $2.5-3 billion while Bonn countered with $1-2 billion).

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[80] "Draft Brief for Chancellor's Talk with Monsieur Giscard d'Estaing: International Monetary Questions," no date (but likely early November 1970; the conversation took place on November 24), UKNA, FCO 59/559.
[81] The full text of the Werner Report can be found: http://aei.pitt.edu/1002/1/monetary_werner_final.pdf

The Werner Report found a less than enthusiastic response from Bonn. Schiller remarked that it stood at "the very limits of what can be accepted responsibly from the standpoint of economic stability." Finance Minister Alexander Möller approved of the report step-by-step plan and shared with his European colleagues that the FRG was prepared to move forward. The report, however, enraged the French. In particular, Pompidou and the Gaullists in the French governments opposed to the proposal of "transfers of responsibility from the national to the Community plane," believing that the states would give up too much sovereignty in exchange for very little substance. Giscard claimed that the "report was one by experts who did not represent the Governments of the countries from which they came." Foreign Minister Maurice Schumann dismissed it as "nonbinding." Pompidou refused to sign an agreement that limited French sovereignty without receiving a high level of economic cooperation immediately.[82] The British– who observed the deliberations from across the Channel with great interest– agreed, describing the Werner Report as an "ambitious Cartesian statement of ultimate objectives, glossing over many of the difficulties of achieving them."[83]After a failed meeting in December 1970, the Council of Ministers came to an agreement in March 1971 to implement the first stage of a three-stage process. This included narrowing exchange-rate margins among the Western European currencies, but also contained a provision that a state could withdraw if it disapproved of how integration proceeded.

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[82] "Talks Between the Chancellor of the Exchequer and Monsieur Giscard D'Estaing," November 1970, UKNA, FCO 59/559; Gray, "Toward a 'Community of Stability'?: The Deutsche Mark Between European and Atlantic Priorities, 1968-1973," in *The Strained Alliance*, 156; "Botschafter [Hans-Georg] Sachs, z.Z. Luxemburg, an das Auswärtige Amt," 27. Oktober 1970, *AAPD 1970, Bd. 3*, dok. 497. The West Germans led the push for the transfer of sovereignty to a European Parliament. They believed that there could be no economic or monetary union without political union because German history proved that there needed to be democratic consent of the whole community before the Community transferred wealth from one country to another. Mark Arnold-Foster to James Callaghan, May 26, 1972, Bodleian Library Special Collections, University of Oxford, England, James Callaghan Papers, Box 43.

[83] "Community Finance: Negotiating Objectives," December 2, 1970, UKNA, PREM 15/62.

The turn toward monetary and economic integration indicated an increased desire in Western Europe to adapt within the Bretton Woods framework to an economy in which unchecked capital flows from the United States could wreak havoc. In addition, the Werner Report sought to reconcile the fact that instability did not just come from across the Atlantic; it also had to grapple with the reality that the emergence of West Germany as a juggernaut was also a source of instability.

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Conditions in the international system did not favor European monetary integration, and financial globalization reared its ugly head again. After a period of about a year and a half without a major currency crisis, speculators wreaked havoc on the exchange market in spring 1971. Once more, the D-mark was the focus of speculative attention–it attracted DM 35.3 billion from January 1970 to May 1971.[84] The D-mark was targeted because of West Germany's strong export position as well as poor trade numbers in the United States. The cost of living in West Germany rose 4.8 percent between March 1970 and March 1971, and the Bonn government believed that domestic policies alone could not stunt the flow of foreign capital into the country, particularly after news spread that the U.S. trade account had fallen into deficit for the first time since 1893.[85] The situation in spring 1971 was "more explosive" than in 1968 and 1969 because now interest rates in West Germany were higher than in the United States.[86] At an April 1971 meeting of the European finance ministers in Hamburg, Schiller sought to garner support for the revaluation of the Western European currencies collectively in an attempt to forge a multilateral

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[84] James, *International Monetary Cooperation Since Bretton Woods*, 215.
[85] A.K. Rawlinson, "Note for Record: Currency Crisis: Communication from German Government," May 10, 1971, UKNA, FCO 59/648.
[86] In 1969, speculators who moved into the D-mark had to take a risk of an interest loss, but in 1971 speculators would "receive an interest bonus." E. Pieske an Abteilungsleiter VI, "Wirkungen einer Kursfreigabe," March 23, 1971, BAK, B 102/84100.

solution to the flow of money into the country. His call did not find support among his Community colleagues–the French in particular considered this course of action "anathema"–but expectant speculators flowed DM 7.5 billion in one week into the West German currency in anticipation of revaluation.[87] Given the strength of the West German economy, "it must now be obvious to speculators and profit seekers generally that the D-mark is a sitting duck," the British Foreign Office observed.[88] On May 5, 1971, the West German government announced the closure of the exchange markets. Three days later, Schiller met with his Community colleagues again in Brussels for 21 hours to plead with them to revalue their currencies as a unit. He emphasized the opportunity to use market mechanisms as a means to accelerate economic and monetary integration within the Community, but with the exception of the Dutch, Schiller found no support.[89] The new speculative crisis presented Bonn with a choice: fight inflation by allowing the D-mark to float unilaterally or maintain the par value under Bretton Woods.

Despite opposition from the Bundesbank, the government allowed the D-mark to float temporarily when the market reopened on May 10. The memory of the runaway inflation in 1923

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[87] Abteilung IIIA1, "Sitzung des Bundeskabinetts am 7. Mai 1971," May 6, 1971, PA-AA, B 52 (Referat IIIA1), Bd. 585. Schiller would also take on the post of Minister of Finance on May 14, taking over for the incumbent Alexander Möller.

[88] D.G. Holland to Peter Bottomley, "Beyond the Immediate Crisis," May 7, 1971, UKNA, FCO 59/648.

[89] Schiller noted that the FRG had accepted over 50 percent of the flow of capital over the past year, but the transnational effects of the enormous transfers of hot money "touches the entire Community." He claimed that "the current situation can become a great moment for further monetary integration and a step forward on the way to economic and monetary union for the Community." For a transcript of Schiller's statement at the meeting in Brussels on May 8, see "Erklärung von Bundeswirtschaftsminister Professor Dr. Karl Schiller zu Beginn der Ratssitzung am 8. Mai 1971 in Brüssel," PA-AA, B 52 (Referat IIIA1), Bd. 585. The other Western European leaders, however, voiced their concern that the West German solution did not promise a solution to the current problem. Belgian Minister of Finance Jean-Charles Snoy et d'Oppuers voiced his doubt that floating the currencies constituted a permanent solution to the problem. French Minister of Finance Valéry Giscard d'Estaing concurred, arguing that "the speculation fever must be overcome by a demonstration of solidarity." The Western Europeans should not abandon the parities and bear the burden of making adjustments, Giscard emphasized, when the real problem lay with the U.S. Schiller found support from only Dutch Minister of Finance Johan Witteveen, who intimated that his government had already considered floating for a short period. The Netherlands – which had close trade ties to West Germany –allowed the guilder to float. The Austrians and Swiss also adjusted their currencies to keep their currencies in line with the D-mark. For a summary of the May 8 meeting, see Vertretung der Bundesrepublik Deutschland bei den Europäischen Gemeinschaften, "Aktuelle Währungslage," May 8, 1971, PA-AA, B 52 (Referat IIIA1), Bd. 585.

weighed heavily on the minds of West German policymakers, and they feared the political and economic effects of increasing inflation. By allowing the D-mark to float, the West Germans sought to achieve two objectives. First, Bonn sought to stop the flow of liquidity into the country and avoid future speculative inflows. Second, floating would provide stability for the domestic economy by ending the inflationary pressure on prices.[90] The West Germans recognized that this step would irritate their Western European colleagues and hurt chances for integration, but they also recognized that "prices are currently the central problem of the economy" and floating the D-mark would provide stability–one of the watchwords of the Bonn government–to the domestic economy.[91] Some scholars have criticized the West German decision, but Bonn's decision to float was prudent. To be sure, the action constituted a setback in European politics. The FRG received backlash from its fellow members of the Community for stalling progress on European monetary integration, particularly from Paris, and the episode confirmed the sobering fact that European monetary and economic integration would not be possible until the Community achieved harmonization of its policies. From a national perspective, however, Bonn valued halting the flow of capital into the D-mark more, and the decision to float did indeed stop the inflow of capital and staved off even more inflation. In addition, Schiller's original proposal that the Community float their currencies as a unit would not have had an impact on internal European trade.[92] Standing firm to maintain the par value of the D-mark as the French minister of finance advised unrealistic given the consistent U.S. policy of "benign neglect." Furthermore,

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[90] Willy Brandt to Walter Scheel, May 7, 1971, PA-AA, B 52 (Referat IIIAI), Bd. 594. Brandt wrote this letter before the Brussels meeting and informed Scheel that if the Community did not float as a group, the FRG's contingency plan was to do so unilaterally. The DM settled to DM 3.51, an effective revaluation of about 4 percent.

[91] Schiller, "Die Wirtschaftslage in der Bundesrepublik Deutschland im Frühjahr 1971, die weiteren Aussichten und wirtschaftspolitischen Schlussfolgerungen," May 5, 1971, BAK, B 102/84100. For a survey of global press reactions to Bonn's decision, see Abteilung III (Referat IIIA1), "Freigabe der Wechselkurse durch die BRD am 9.5.1971: Pressestimmen des Auslandes," May 13, 1971, PA-AA, B 52 (Referat IIIA1), Bd. 585.

[92] Gray characterizes West German monetary policy in spring 1971 as "mismanagement." Gray, "Floating the System," 307.

floating the D-mark allowed the currency to reach a more realistic value and insulated West Germany from the events of August 1971; money poured into Japan and France instead of the FRG. With Bonn's priorities and the domestic political pressure to ensure that inflation did not get out of hand, the difficult decision to float was the correct one.[93]

The Dutch faced a similar assault on their currency as the West Germans. They too had an export surplus, and speculators believed that the guilder was a prudent investment. When the Dutch exchange market closed (along with the West German, Swiss, and Austrian) on May 5, the President of De Nederlandsche Bank Jelle Zijlstra reported to the Council of Ministers that $250 million had rushed into the country just the hour before it closed. As the Dutch considered how to respond, conversation focused on the reaction of the West Germans. Zijlstra said, "The problem that we now face is what to do next. For this it is necessary to know what West Germany is doing….The Netherlands faces the same choice as West Germany."[94] When The Hague learned that Bonn would float the D-mark, it was an almost foregone conclusion that the guilder would do so as well. The Dutch not only wanted to stem the flow of hot money into the country, they also wanted to ensure that the West German float did not disrupt the close trade relationship. Finance Minister Johan Witteveen shared on May 9 that he expected the value of the D-mark to rise by about five percent. The guilder did not need to march in lockstep with the D-mark, but it did need to track it enough so that the D-mark did not become too powerful.[95]

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[93] In a letter to Nixon, Brandt explained that he undertook the measure to preserve the stability of West Germany. Although Bonn allowed the D-mark to float unilaterally, the chancellor stressed that the FRG remained committed to the process of European integration. Brandt an Nixon, 11. Mai 1971, Archiv der sozialen Demokratie der Friedrich-Ebert Stiftung (AdsD), Bonn, Germany, Willy Brandt Archiv, A8/60.

[94] "Verslag van de bespreking gehouden op woensdag 5 mei 1971 in de vergaderzaal van het Kabinet van de Minister-President, aangevangen 's middags om half een," May 5, 1971, Nationaal Archief (NNA), The Hague, Netherlands, 2.02.05.02, 1105.

[95] Ministerraad, "Notulen van de vergadering gehouden op zondag 9 mei 1971 in de vergaderzaal van het Kabinet van de Minister-President, aangevangen 's middags om 4 uur," May 9, 1971, NNA, 2.02.05.02, 1105.

The ramifications of the D-mark float in September 1969 weighed on the minds of Dutch policymakers. After the West Germans revalued the D-mark on October 24, 1969 by 9.3 percent, State Secretary of Foreign Affairs Hans de Koster reminded the group that last time after the revaluation of the D-mark, so much Dutch wheat was exported to West Germany that the Dutch had to buy wheat elsewhere. The Netherlands would be "forced to follow" the West German decision, "because otherwise the suction on our exports would be too great." Minister of Economic Affairs Roelof Nelissen concurred, arguing "the worst thing that can happen is that our economic position would deteriorate because of the temporary extra suction-power [*zuigkracht*] from West Germany." The Council of Ministers concluded that in the agricultural sector, the Dutch could tolerate a variation of no more than 2.5 percent. This *zuigkracht* would be smaller when the guilder floats, Witteveen concluded, and "probably can neutralize the deterioration of our export position somewhat."[96]

The Dutch case demonstrates growing power of the D-mark as a major currency. Conversations at The Hague focused on how the D-mark would react to the inflow of capital; the United States was of secondary concern. Allowing the D-mark to float and not following suit would allow West Germany to have too much economic power. It also indicated that although the Dutch placed value on European integration, their fears about inflation and the changing the terms of trade with its largest partner outweighed wanting to adhere to the principles of the Werner Report.

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The May 1971 float of the D-mark stopped the flow of money into West Germany, but speculators redirected toward other currencies, particularly the Japanese yen, in anticipation of a

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[96] Ibid.

devaluation of the U.S. dollar. The release of economic data about the U.S. economy provided the stimulus. On August 6, 1971, the U.S. Congress Joint Economic Committee's Subcommittee on International Exchange and Payments under Henry S. Reuss (WI-D) issued a report in June that revealed the scale of the U.S. deficit and concluded that the dollar was overvalued. By the summer, the U.S. was on pace for a deficit in 1971 that would total $22 billion. The dollar overhang continued to grow as well; by the end of August, official holders of U.S. debt had $44 billion of U.S. liabilities denoted in dollars, but Fort Knox only held about $12 billion worth of gold.[97] U.S. policymakers feared that foreign governments would rush to cash in their dollars for gold before the precious metal ran out. A rumor emerged that the Bank of England in a panic had requested that the U.S. exchange $3 billion into gold–British policymakers later denied the charge.[98]

Nixon called his top economic advisers to a meeting from August 12-13 at Camp David to discuss the international monetary system; despite State Department requests, no foreign policy representative attended the discussions.[99] The central figure–or "big wheel" in Nixon's

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[97] In comparison, U.S. gold reserves reached a high in 1949 at a value of $26.2 billion. Wilson E. Schmidt to A.S. Petty, "Requirements for a Secure U.S. Balance of Payments Positions," November 24, NARA, RG 56, OASIA, FLW, Mr. Widman's Chron – November 1971, Box 4.

[98] Edwin L. Dale, "Devalued Dollar is Asked in Study," August 8, 1971, *NYT*, p. 1 An article surfaced in *Fortune* in January 1972 claiming that a "panicked request from the Bank of England for a guarantee against devaluation of its dollar holdings totaling some $3 billion" accelerated the "Nixon shock" of August 1971. The Bank of England later argued that never made that request. It did inquire about the swap facility with the New York Fed., and the New York Fed. answered that it could offer up to $750 million, a figure that comported with the inflow of U.S. dollars into the United Kingdom since August 1. This proposal was accepted. See Robert Armstrong to Edward Heath, January 13, 1972, UKNA, PREM 15/838. In his memoirs, however, Nixon claimed that the British ambassador appeared at the Treasury to request that $3 billion be converted into gold. He stated that Connally deferred giving an answer. Nixon, *The Memoirs of Richard Nixon: Volume 1* (New York: Warner Books, 1978), 642. Connally supports this argument in his memoirs. See Connally, *In History's Shadow*, 237. For a good survey of the economic issues facing the Nixon administration, see Paul W. McCracken to Nixon, August 9, 1971, RNPL, White House Central Files, Subject Files, FO Foreign Affairs, FO 4-1 1/1/71-12/31/71 [2 of 3], Box 44.

[99] With the support of Secretary of State William Rodgers, Under Secretary of State John Irwin stressed to Paul Volcker that State "be involved in any decision-making in the international monetary area." Volcker passed along the request to Connally, but it was not granted. See Paul A. Volcker to John B. Connally, August 13, 1971, NARA, RG 56, Records of Secretary of the Treasury George P. Shultz, 1971-1974, Econ. Game Plan Background Camp David 8/13-15, '71, Box 7. On State's annoyance at not being part of the decision, see also Martin J. Hillenbrand journal entry for August 17, 1971, Richard B. Russell Library for Political Research and Studies, University of

words–of the decision was Secretary of the Treasury John B. Connally, a former Democratic Governor of Texas and Johnson's close friend.[100] He told Nixon, "our problems are basically, to the extent that we have them, right here at home. And when they're solved, your international problems are solved, your international trade problems to a large extent are solved, because it's merely a reflection."[101] Connally advised that the president introduce a series of international and domestic measures, including a closure of the gold window. His view was that "the foreigners are out to screw us and therefore it's our job to screw them first."[102]

The internationalists in policymaking circles cringed at the thought of closing the gold window. In particular, Chairman of the Federal Reserve Arthur F. Burns emerged as Connally's primary opponent. He proposed taking domestic measures such as an import surcharge to rectify the U.S. deficit, but he feared the international ramifications of changing the par value of the dollar. Burns particularly worried that the closure would precipitate a panic in the world markets

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Georgia Libraries, Athens, Georgia, Martin J. Hillenbrand Papers, Folder 19: August 5, 1971–August 29, 1972, Box II.2. Kissinger confirms this in the first volume of his memoirs, stating that neither he nor Rodgers was consulted. Kissinger, *White House Years*, 954.

[100] "Telecon: The President/Mr. Kissinger," August 16, 1971, RNPL, Henry A. Kissinger Telephone Conversations (Telecons), Chronological Files, 1971 11-19 Aug (2 of 11) [2 of 2], Box 11. In a move that surprised commentators at the time, Connally–who had virtually no economic or financial background – took over for the incumbent David M. Kennedy in December 1970. An article in *The Times* noted that "Mr. Connally knows as much about economics as most economists know about cattle ranching." Geoffrey Bell, "Democratic Ginger for the American Economy," December 29, 1970, *The Times*, p. 13. With an eye on the upcoming presidential election in November 1972, Nixon expected that having a Democrat in charge of Treasury would prove politically useful in gaining the approval of a Democratic-controlled Congress. Kennedy had proven to be an ineffective advocate for the Nixon administration's economic policies and appointing the gregarious and charismatic Connally seemed to have the qualities that would help push across the president's plans. Connally was a follower of the new Assistant to the President for International Economic Affairs Peter G. Peterson, whom Nixon appointed in 1971. In an April 1971 report to Nixon and Connally, Peterson depicted a mercantilist interpretation of America's role in the international economy. The U.S. place in global manufacturing was declining, and the rest of the world deployed discriminatory trade practices in bilateral trade agreements. It was time, Peterson believed, "to end America's 'benevolent' approach to the world." William H. Becker, "The U.S. and the Search for a New Monetary System," in *The Strategic Triangle*, 198-99. As the situation worsened, Peterson made his case more strongly to Nixon. See, for example, Peter G. Peterson to Nixon, "Briefing on the U.S. in the Changing World Economy, Where Do We Go From Here, and Proposed Work Program of the Council," July 6, 1971, NARA, RG 56, Records of Secretary of the Treasury George P. Shultz, 1971-1974, Council on International Economic Policy 3 of 4, Box 7.

[101] Douglas Brinkley and Luke A. Nichter, eds., *The Nixon Tapes: 1971-1972* (Boston and New York: Houghton Mifflin Harcourt, 2014), 239.

[102] George C. Herring, *From Colony to Superpower: U.S. Foreign Relations Since 1776* (New York: Oxford University Press, 2008), 782.

and cause an economic depression. In his diary on August 12, Burns wrote, “The gold window may have to be closed tomorrow because we now have a government that seems incapable, not only of constructive leadership, but of any action at all. What a tragedy for mankind!”[103] When Nixon wondered about the cogency of that argument, Connally cast it aside. Connally countered: “So the other countries don’t like it. So what?...What can they do?”[104] What was really important, Connally believed, “is the impact on the American people, and their reaction to you and what you did, and their reaction to your action….The international thing, hell, it’s going to be in turmoil or a state of turmoil or semi-turmoil from now on….And I just don’t think you ought to worry too much about that.” If Nixon only announced a domestic program–as Burns suggested–and it failed, Nixon would be forced then to close the gold window anyway. In the year before Nixon’s reelection campaign, Connally feared that Nixon would look weak and that Nixon “didn’t know what to do, it took you from now, from tomorrow, to September 7 to figure out what to do, and that you were merely reacting.” Recent polls had suggested that American people viewed the Democrats as the party of prosperity, but a decisive action, Connally believed, would give Nixon the initiative.[105]

Connally’s argument carried the day. As Burns noted, domestic politics played a crucial role. Nixon reasoned that “if we left the window open and then realigned the exchange rates, the new arrangement might prove ephemeral and blow up next year before the election. To be sure, the immediate response–both here and abroad–would be unfavorable; but it was better to take the criticism” in 1971 rather than closer to Nixon’s reelection campaign in 1972.[106] On August 15,

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[103] Arthur Burns diary entry for August 12, 1971, GFPL, Arthur Burns Papers, 1969-87, Personal File, Handwritten Journals, 1969-1974, Journal I–Green Notebook, January 20, 1969 – August 12, 1971, Box 1.
[104] James, *International Monetary Cooperation Since Bretton Woods*, 219.
[105] Brinkley and Nichter, eds., *The Nixon Tapes*, 237-39.
[106] Arthur Burns diary entry for August 22, 1971, GFPL, Arthur Burns Papers, 1969-87, Personal File, Handwritten Journals, 1969-1974, Journal II – Blue Notebook, August 22, 1971 – July 25, 1974, Box 1. In addition to disagreeing with the decision on economic grounds, Burns lamented the way that Nixon’s personal insecurity drove

Nixon announced the New Economic Policy (NEP)–a name that inadvertently recalled the Soviet economic policies of the 1920s–in an address to the nation. He imposed a 10 percent surcharge on imports into the United States and issued a wage-price freeze in an effort to control inflation. Most dramatically, he suspended the convertibly of the dollar into gold. The time had finally come, Nixon declared, for America's allies pay their fair share. After the devastation of the Second World War, the U.S. provided Western Europe and Japan with billions of dollars of aid, and they blossomed into "strong competitors." Now that they had successful economies of their own, "there is no longer any need for the United States to compete with one hand tied behind her back." In addition, the decoupling of gold to the dollar, he believed, would manage the destabilizing effects of economic globalization. "I am determined that the American dollar must never again be a hostage in the hands of international speculators." To his domestic audience, he "lay to rest the bugaboo of what is called devaluation" by assuring them that most U.S. consumers would not feel the effects of the measure.[107]

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policymaking. Reflecting on the Camp David meeting in his August 22 diary entry, Burns wrote "the weekend confirmed my growing feeling that President needs to act in a way that satisfies his hunger for drama and novelty, that he lacks true self-assurance and that therefore requires some dramatic act to convince himself that he is a strong leader." During the election campaign of 1972, Burns reflected that "August 15, 1971 was a definitive and decisive turning point in the President's state of mind," a moment that gave him the self-confidence that he had lacked in the first years in office. In November 1971, he criticized they way that U.S. monetary policy was formed. He characterized Shultz as "a man who should know that he has not the slightest understanding of international economics or finance! What a pity that this quiet, persuasive, but woefully ignorant ideologist, has such influence with the President….Connally, a thoroughly confused politician, suppressing his desire to punish foreigners in view of the President's moving away from narrow domestic political; I, the only one there with any knowledge of the subject, but even I not a real expert on some aspects of the intricate international problem! What a way to reach decisions! No one from the State Department there, no technical experts to aid us!" Arthur Burns diary entries for November 26, 1971 and October 26, 1972, GFPL, Arthur Burns Papers, 1969-87, Personal File, Handwritten Journals, 1969-1974, Journal II–Blue Notebook, August 22, 1971–July 25, 1974, Box 1.

[107] Richard Nixon, "Address to the Nation Outlining a New Economic Policy: 'The Challenge of Peace,'" August 15, 1971. Online by Gerhard Peters and John T. Woolley, The American Presidency Project. http://www.presidency.ucsb.edu/ws/?pid=3115. Domestically, the action largely received high marks. Kissinger called Nixon to congratulate him the following day, saying "Congratulations, you scored another coup!....I don't know anything about these things, but it looks like a damn ingenious program to me." "So many have said that it was like the China news. It reminds people of that again." 8/16/71 HAK Telecon Box 11

The NEP marked a significant shift in U.S. economic foreign policy. After the end of the Second World War, Washington consistently sacrificed its economic interests in favor of its strategic desire to encourage the economic development of its Japanese and Western European allies. In August 1971, however, the calculus changed. The goal of the new policy was to make American exports more competitive and redress the balance of payments deficit at the expense of America's Cold War allies. Nixon and Connally believed that the suddenness of the closure of the gold window and 10 percent import surcharge would precipitate a shock sufficient–Washington did not warn its allies ahead of time–to compel the Japanese and Western Europeans to take measures of their own that would provide for an effective devaluation of the dollar.[108]

Beyond the objective of provoking a crisis to improve the U.S. balance of payments, however, the Nixon administration had little idea of what it wanted. On August 16, the president sent Under Secretary of the Treasury Paul Volcker to London to explain to representatives of several European countries and Japan the reasoning behind the measures. Volcker informed them that the Nixon administration had no blueprint for a reform of the international monetary system–that was for the Europeans and Japanese to figure out. Volcker's mandate in London, he explained, was not to negotiate; "it was basically now for the other main countries to consider what programme of measures, including parity changes, would bring about the necessary

[108] Nixon's measures of August 15 also, of course, ended one of the central tenants of Bretton Woods – the certainty of the convertibility of dollars into gold at $35 per ounce. This has led some observers to say that Bretton Woods ended in August 15. In late August 1971, an obituary notice circulated within the IMF for Bretton Woods, stating: "R.I.P. We regretfully announce the not unexpected passing away after a long illness of Bretton Woods, at 9 p.m. last Sunday. Bretton was born in New Hampshire in 1944 and died a few days after his 27th birthday. Although abandoned by some of his parents in infancy, he was a sturdy lad and was expected to survive. Alas, in the early nineteen-sixties liquidity anemia set in. The fatal stroke occurred this month when parasites called speculators inflated his most important member and caused a rupture of his vital element, dollar-gold convertibility." Quoted in Alfred E. Ekes, Jr., *A Search for Solvency: Bretton Woods and the International Monetary System, 1941-1971* (Austin, TX: University of Texas Press, 1975), 266.

strengthening of the American payments position."[109] Nixon's action brought about no change in the exchange rate of the dollar. "Others would make that decision; we could not," Volcker told Giscard.[110]

Many expected the Nixon administration to take some sort of action to halt the outflow of gold from U.S. coffers. "Nixon's blunt act of brinkmanship," however, came as a surprise.[111] The British Treasury, for example, admitted that it caught Whitehall somewhat "on the hop." The British had penned countless memoranda about the looming crisis in the monetary system and considered their options in the event of a variety of U.S. actions, but they could not agree on a firm contingency plan.[112] In France, Giscard found himself caught between having to revalue the franc (thereby betraying his earlier position that he would not) and standing firm (but perhaps isolating France from her Western European partners). The timing further complicated French policy because Pompidou, Giscard, and the other ministers were away from Paris on their August holidays.[113] The announcement was all the more unexpected because it betrayed Washington's long-time policy of benign neglect, and came from "an administration that was up to this point asleep on this problem."[114]

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[109] Alec Douglas-Home (London) to certain posts, "International Monetary Situation," August 17, 1971, UKNA, FCO 59/650.
[110] "Memorandum of Conversation: Volcker and Giscard," August 17, 1971, *FRUS, 1969-1976, Vol. 3*, doc. 171. Beyond the exchange-rate question, the Nixon administration had little idea about how the import surcharge would affect U.S. imports. Estimates within the government ranged from $4.5-5 billion (New York Federal Reserve and the Department of State) to $1.7 billion (Department of Commerce). David J. Klock to F. Lisle Widman, "Various Estimates of Surcharge Effect on U.S. Imports," November 16, 1971, NARA, RG 56, OASIA, FLW, Mr. Widman's Chron–November 1971, Box 4. Its purpose was to give Washington another bargaining chip, but the reality was that the surcharge did not affect the Western Europeans too much and only served to convince the Community that Washington would no longer negotiate constructively.
[111] Zimmerman, "Unraveling the Ties That Really Bind," in *The Strained Alliance*, 137.
[112] Treasury Historical Memorandum No. 30, "The Collapse of the Bretton Woods System 1968-1973," October 1976, UKNA, T 267/36.
[113] Arthur Michael Palliser (Paris) to FCO, "French Reaction to the International Monetary Crisis," August 17, 1971, UKNA, FCO 59/650.
[114] Luke A. Nichter, *Richard Nixon and Europe: The Reshaping oft he Postwar Atlantic World* (New York: Cambridge University Press, 2015), 70.

Discussion in Western Europe and Japan tended to focus naturally on the international aspects of the NEP: the suspension of the convertibility of the dollar into gold and the import surcharge. The surcharge did not hurt the Western Europeans too much because trade with the U.S. did not constitute much of their overseas trade. In the case of France, for example, it only represented about four percent of French exports.[115] At a September 1971 meeting of the Group of Ten (G-10), the Europeans argued unsuccessfully that the Nixon administration needed to remove the surcharge and commit to a devaluation of the dollar. "All countries should…take part in such a realignment," Schiller stressed," because otherwise the burden placed on individual countries would become too heavy."[116] Schiller made his case cordially, but that was unique among his European colleagues–most denounced "the outrageous demands of the Americans."[117] Nixon and Connally, however, refused to consider a devaluation. If the price of gold were raised, it may signal to speculators that the adjustment of the price of gold would be an instrument to remedy imbalances, leading to more speculation and uncertainty. They also believed that part of the reason that the other industrial democracies demanded a devaluation of the dollar "as a means of embarrassing the United States."[118]

At the Rome conference of the G-10 in November 1971, the Nixon administration made its first constructive proposal in an effort to resolve the situation. As a *quid pro quo*, Connally offered the removal of surcharges for corresponding changes in parities that would achieve an 11 percent appreciate of other currencies against the dollar.[119] The West Germans believed that the

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[115] Connally to Nixon, "Memorandum for the President: Monetary and Trade Issues Aiming at the Azores Meeting," December 10, 1971, NARA, RG 56, Records of Secretary of the Treasury George P. Shultz, 1971-1974, JBC – Memorandum for the President 1971, Box 7.
[116] "Statement by Minister Professor Dr. Karl Schiller at the Group of Ten Conference, London, September 15 and 16, 1971," PA-AA, B 52 (Referat IIIA1), Bd. 634.
[117] Nichter, *Richard Nixon and Europe*, 75.
[118] Connally, *In History's Shadow*, 241.
[119] Roger Hormats to Kissinger, RNPL, NSC Files, Subject Files, Monetary Matters, Azores Dec 1971, Box 356.

Rome conference "could not have gone better."[120] The problem was reconciling the U.S. position with the French–Britain and West Germany would seek to avoid siding with one over the other. The U.S. and French met on the Portuguese island of the Azores on December 13 to reach a bilateral understanding with Pompidou before ratifying it at the G-10 conference in Washington two weeks later. At Azores, Pompidou agreed to revalue the franc, but only an amount that was less than the revaluation of the D-mark (to maintain France's competitive trade position).[121] After the U.S. and France reached a compromise, the G-10 confirmed the bargain at the Smithsonian Institute in Washington in mid-December. Under the terms of the Smithsonian Agreement, the United States lifted the surcharge and the other countries agreed to revalue their currencies. The U.S. agreed to propose to Congress an increase in the price of gold to $38 per ounce, a devaluation of 8.57 percent. The agreement also stipulated that IMF member currencies could not go beyond 2.25 percent of its parity against the dollar in either direction (a total band of 4.5 percent).[122]

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Nixon hailed the Smithsonian Agreement as "the most important monetary agreement in the history of the world," but most agreed that the Smithsonian Agreement only placed a bandage on Bretton Woods.[123] It did not adapt Bretton Woods to the new challenges of financial

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[120] Gruppe IV/1 an Abteilungsleiter IV, "Ergebnisse der Währungskonferenz in Rom," December 2, 1971, BAK, B 136/7351.

[121] Kissinger, who participated in the Azores summit, remembered that the Azores was selected because it was a neutral site. It had been Nixon's turn to visit France, but the president could not justify travelling to Paris and not the other European capitals. Pompidou did not agree to the U.S. proposal of holding the summit in the West Indies because it was so far from France and, although French controlled, the West Indies was not comparable to Pompidou's previous visit to the U.S. Kissinger, *White House Years*, 959.

[122] Rogers to all diplomatic posts and missions, "Summary of Ministerial Meeting of Group of Ten from Treasury Secretary Connally," December 19. 1971, NARA, RG 59, Subject-Numeric Files 1970-1973, Economic, FN 17 11/1/71, Box 834.

[123] Nixon quoted in a speech by Otmar Emminger, "The Balance From Washington," no date, NARA, RG 59, Subject Numeric Files, 1970-73, Economic, FN 17 1/1/72, Box 835.

globalization; it provided “breathing space” for the world to find a more enduring solution.[124] After the Smithsonian Agreement, the members of the Community once again redirected their attention to regional politics and the difficulties of the economic and monetary union. The Community had taken a big step forward in 1970 and 1971, but the West German and Dutch floats in May 1971 and the dislocation of the Nixon shock forced the Community to concentrate on transatlantic relations. In an effort to narrow the margins between their currencies, the Community agreed in March 1972 to go beyond the 4.5 percent width that the Smithsonian Agreement allowed and limited the maximum deviation at 2.25 percent (1.125 percent in either direction) from the existing parities. If the currencies reach the outer limit of 2.25 percent, both central banks involved would have to intervene and correct the relationship. The main argument in support of this project–which became known as the “Snake in the Smithsonian tunnel” after it went into force in April 1972 under the Basle Agreement–was that closer coordination of the currencies would protect the Community from unwelcome unilateral policies across the Atlantic and subsequent capital movements.[125]

Scheduled to join the Community in January 1973, the British watched the formation of the Snake with great interest. Upon entry into the Community, Britain agreed to adopt whatever decisions on monetary policy that had already been concluded. Whitehall doubted, however, whether this policy was beneficial for Britain. In particular, the Treasury came out against the Snake, believing that the Smithsonian margins served British interests better. The Treasury argued that the Snake encouraged speculation because the rigidity of the 2.25 percent band implied more frequent adjustments. Furthermore, the strength of the D-mark, Treasury feared,

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[124] D.J. Mitchell, “Some Thoughts on the Political Imperatives for Europe and America for a Return to World Monetary Order,” May 11, 1972, UKNA, PREM 15/812.
[125] Karl Schiller, “Internationale Wirtschafts- und Währungspolitik: Stand und nächste Aufgaben,” May 2, 1972, BAK, B 102/84149.

would drag the Snake upward against the dollar, bringing the effective sterling exchange rate higher than officials in London wanted. As sterling was weak in 1972, the opposite was also a threat: if the weakness of the pound dragged the Snake downward, the exchange rate of the D-mark would be lower than it should, and West Germany would doubtless be the destination for fleeing capital. These were disadvantages, however, "which had to be accepted on political grounds" in order to gain access to the European common market.[126]

The Community put the Snake into operation in late April 1972, and Britain joined the following month. Within a few weeks, sterling came under attack. Although the British enjoyed a surplus in the balance of payments, speculators worried about the current account that fell into deficit. In addition, labor relations soured over the new Industrial Relations Act, and observers worried about how the British economy would perform against Europe competition.[127] The crisis in mid June cost the British government about $2.5 billion to maintain the par value of the pound, and Britain lost about a third of its reserves. On June 23, the British government announced that it would allow sterling to float and withdraw from the Snake. Because sterling was the second reserve currency behind the dollar, the British decision to float in June "was an event second in importance only to the floating of the U.S. dollar in August 1971."[128] Although the British received some criticism, particularly from the French for not consulting the Community before abandoning the fixed parity, Chancellor of the Exchequer Anthony Barber

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[126] Treasury Historical Memorandum No. 30, "The Collapse of the Bretton Woods System 1968-1973," October 1976, UKNA, T 267/36. As future members, Denmark and Ireland also joined the Snake in spring 1972.

[127] The Industrial Relations Act of August 1971 sought to concentrate power of labor in the union leadership and limited the ability of individual workers to bring grievances against their employers. On the American intellectual origins of the legislation, see Hamish R. Sandison, "A Rejected Transplant: The British Industrial Relations Act (1971-1974)," *Berkeley Journal of Employment & Labor Law* 3, no. 2 (Summer 1979): 247-320.

[128] Denmark left the Snake as well shortly thereafter. Treasury Historical Memorandum No. 30, "The Collapse of the Bretton Woods System 1968-1973," October 1976, UKNA, T 267/36. The Nixon administration believed that the British decision to float the pound confirmed U.S. policy of refusing to consider convertibility until the international community erected a stable economic system. "Memorandum From the President's Assistant for International Economic Affairs (Flanigan) to President Nixon," June 23, 1972, *FRUS, 1969-1976, Vol. 3,* doc 232.

found sympathy from his European counterparts.[129] The float of sterling confirmed the vulnerability of the patchwork Smithsonian agreement to financial globalization.

Many Western Europeans continued to blame the United States and what they considered to be Washington's cavalier attitude toward the protection of the Smithsonian Agreement. New West German Minister of Economics and Finance Helmut Schmidt informed U.S. Assistant Secretary of State for European Affairs Martin J. Hillenbrand that "he could not understand the passivity of the US in the international monetary field during recent months." This made it extremely difficult for the Europeans to believe that Washington was serious about protecting the Smithsonian rates. He warned that if speculators attacked the D-mark once again, West Germany "would not hesitate to impose controls."[130] The West Germans would no longer sacrifice their interests to protect the dollar exchange rate. In addition, Schmidt pointed to the expanded use of SDRs as a prudent way of increasing reserves and decreasing the centrality of the dollar. West German and French policymakers agreed that "freedom of capital movement should not be dogma…. If a country has a deficit, it should not allow capital to flee without restrictions."[131] NSC adviser Robert Hormats admitted "the European case for such a system is essentially rational."[132]

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[129] "Conclusions of a Meeting of the Cabinet," June 27, 1972, UKNA, CAB 128/50, CM(72).

[130] Martin J. Hillenbrand (Bonn) to State, "Conversation with Economics and Finance Minister Schmidt," August 1, 1972, RNPL, NSC Files, Subject Files, Monetary Matters, Azores Dec 1971, Box 356.

[131] Abteilung VI A 3 an Abteilungsleiter VI, "Deutsch-französisches Gespräch vom 20.6.1972 über Fragen der Reform des Währungssystems," June 21, 1972, BAK, B 102/84150. Giscard agreed with the need to expand the use of SDRs, but he stressed that the value of the SDR should be expressed in terms of gold. In an interview following an anticipated September 1972 speech at the IMF, Giscard said, "we must never forget that we are now living in a very new world." The West had opened trade with the Eastern bloc, and there existed a chance that the Japanese would enter negotiations with the Chinese. These socialist countries did not use the currencies that constituted the SDRs, and gold should be the common denominator as the socialists entered the international economy. This theme will be addressed in more detail in chapter five. "Giscard States View on Reform," September 29, 1972, *New York Herald Tribune*.

[132] Robert Hormats to Kissinger, "Marked Improvement in International Improvement in International Monetary Situation–With Future Problems on the Horizon," March 1972, RNPL, NSC Files, Subject Files, Monetary Matters, Azores Dec 1971, Box 356.

Policy in the U.S. Treasury, however, moved in the opposite direction. The appointment of George P. Shultz to the post of secretary of the treasury in June 1972 oriented Washington toward a market-based solution. The first to hold that position with a PhD, Shultz had served on the faculty of the University of Chicago alongside Milton Friedman–a chief proponent of floating exchange rates–and himself embraced floating as a means of advancing financial globalization.[133] Together with Volcker, Shultz developed a scheme known as Plan X, an ambitious blueprint for the international monetary system that envisioned greater flexibility. It permitted floating in a number of cases, including "indefinitely" if the country promised not to put in controls on the flow of capital and trade. Plan X tended to limit the ability of the government to intervene in its domestic economy, allowing speculators to move capital with freedom. In an effort to accommodate the emerging European economic and monetary union, Plan X allowed a group of countries that wished to maintain small margins and wanted to move toward reserve pools to exist as a "monetary and trading unit."[134] The British decision to float the pound in June 1972 seemed to confirm Shultz's suspicion of fixed exchange rates. He told Nixon, "the British had these successive devaluations that were not…too successful, they now have a float, which they regard as much more successful, because a float basically insulates you against this kind of speculative rate. The rate just moves rather than there being an accumulation of dollars going in here, or going out of there. So that is…an advantage to the floating system."[135]

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[133] Sargent, *A Superpower Transformed*, 119. Friedman had been advocating the benefits of floating exchange rates for at least a couple decades. See, for example, Milton Friedman, "The Case for Flexible Exchange Rates," in *Essays in Positive Economics,* ed. by Milton Friedman (Chicago: University of Chicago Press, 1953).
[134] "Paper Prepared in the Department of the Treasury: Major Elements of Plan X," July 31, 1972, *FRUS, 1969-1976, Vol. 3*, doc. 239.
[135] "Conversation Among President Nixon, Secretary of the Treasury Shultz, and the Chairman of the Federal Reserve System Board of Governors (Burns)," February 6, 1973, FRUS, 1969-1976, Vol. 31, doc. 3, 11.

The American refusal to intervene in the money markets to support the dollar caused the currency to weaken further for the rest of year. The death knell for Bretton Woods arrived early the following year. Once again, speculators reacted to the publication of economic data. In February 1973, the press reported a record U.S deficit in 1972 and West German figures showing a $4.4 billion surplus.[136] The Euromarkets continued to grow in 1972, increasing by 37 percent against December 1971 and bringing total deposits to $98 billion–a figure that dwarfed U.S. reserve assets by seven-and-a-half times.[137] Capital rushed into West Germany from the United States, totaling $3 billion in a few days. Brandt appealed to Nixon to begin negotiations for a new international monetary system. West Germany had fulfilled its duties under the Smithsonian Agreement "to the letter," Brandt wrote, and called on Washington to do the same by supporting the dollar.[138] Bonn also attempted to organize a joint float among the members of the Community. Schmidt recognized that the most effective way of stemming the dollar inflow into the FRG was to float the D-mark unilaterally, but he and his colleagues were reluctant to act alone as they had in May 1971. Pompidou refused to consider a joint float. The French president argued that the source of the American deficit rested with Japan, not Europe, and he did not understand "why the European currencies, whose countries and governments were not responsible for the deficit, should increase the prices of their exports and hurt their 'Terms of Trade' in the world economy."[139] In order to stave off another crisis, the great powers agreed on February 12 that the United States would devalue the dollar by ten percent, the yen would float,

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[136] James, *International Monetary Cooperation After Bretton Woods*, 241.
[137] Sargent, *A Superpower Transformed*, 124.
[138] Brandt an Nixon, 9. Februar 1973, *AAPD 1973*, *Bd. 1*, doc. 44. English translation is in NARA, RG 59, Subject Numeric Files, 1970-73, Economic, FN 10 GER 1/1/72, Box 884.
[139] "Freiherr von Braun an Auswärtiges Amt," 10. Februar 1973, *AAPD 1973, Bd. 1*, dok. 46.

the Western European currencies would remain unchanged, and sterling would continue to float.[140]

This arrangement survived for only a month when a new crisis–"essentially attributable to speculative factors"–arrived.[141] On March 1 alone, the West Germans absorbed $2.7 billion, the Dutch $500 million, and the French and Danes significant amounts as well. Several exchange markets in Western Europe closed the following day. The main debate in the Western European capitals centered on the issue of whether the Community should move toward a joint float against the dollar. Brandt reintroduced the idea of reconstructing fixed parities among the Community currencies and floating as a unit against the dollar. Bonn, Brandt informed Heath, was "very reluctant to act in isolation." State Secretary of the Finance Ministry Karl Otto Pöhl added that the experience of the D-mark float in May 1971 "had brought the Community near the breaking point." Floating unilaterally in March 1973 "would be very useful and would reinforce their attempts to contain inflation," but Bonn did not want to postpone the achievement of European monetary union.[142] In addition to economic concerns, Brandt wanted to integrate the FRG more fully into Western European institutions so as to put to rest the fears about West Germany gravitating toward the Eastern bloc during *Ostpolitik*. The French, in contrast, stressed

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[140] For a description of the meeting, see "Runderlaß des Vortragenden Legationsrats I. Klasse Dohms," 13. Februar 1973, *AAPD 1973, Bd. 1*, dok. 50. On the agreement with the Japanese, see "Note by the Under Secretary of the Treasury for Monetary Affairs (Volcker)," February 15, 1973, *FRUS, 1969-1976, vol. 31*, doc 13. The smaller members of the Community, including the Benelux countries, "sounded off" at the Council of Finance Ministers meeting of February 14 because the larger countries had not consulted them on the agreement with the U.S. This was become a theme throughout the decade as the Community evolved and faced new challenges. Arthur Michael Palliser (Brussels) to FCO, "Council of Finance Ministers: 14 February. International Monetary Crisis," February 15, 1973, UKNA, FCO 59/853. For the text of Shultz's announcement of the agreement, see "Statement by Secretary Shultz on Devaluation of the Dollar," February 13, 1973, *NYT*, 56.

[141] Arthur Michael Palliser (Brussels) to FCO, "Currency Crisis: Council of Finance Ministers," March 8, 1973, UKNA, FCO 59/855.

[142] Nicholas Henderson (Bonn) to FCO, March 2, 1973, UKNA, FCO 59/854.

the need to defend the existing par value system. As they had three weeks prior, they saw no reason for the Western European currencies to appreciate against the dollar.

On March 11 and 12, 1973, the Community considered the West German proposal at the Council of Ministers. West German and French officials managed to reach a compromise: France agreed to participate in the float, and the West Germans promised appreciate the D-mark by three percent relative to the franc. The terms of the Community's float included a confirmation of the 2.25 percent deviation rule of spring 1972, a promise to implement more capital controls to limit speculation, and an end to the central banks' responsibility of intervening to protect the parity of their currencies against the dollar. They demanded that the United States collaborate to implement capital controls to limit the freedom of capital to move quickly from one market to the next.[143] Six members of the Community joined the float, including Belgium, Denmark, France, West Germany, Luxembourg, and the Netherlands. Britain, Ireland, and Italy declined to participate because of the weakness of their currencies, but voiced their intention of joining the float in the future.[144] Thus, the Community ended the central tenant of Bretton Woods–the fixed relationship of the dollar to other currencies.

The Nixon administration watched the joint European float with a mixture of emotions. The United States had generally supported European integration since the late 1940s on the

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[143] "Übersichtsvermerk für währungs- und handelspolitische Gesprächsthemen mit Finanzminister Shultz, " March 14, 1973, BAK, B 102/111917.
[144] "Botschafter Sachs, Brüssel, (EG), an das Auswärtige Amt," March 12, 1973, *AAPD 1973, Bd. 1*, dok. 80. Heath informed Bonn that Britain would only join if the Community met his conditions. If London ended its policy of floating and fixed the parity of sterling, Heath feared that speculators would flee the pound in the amount of $5 or 6 billion. In particular, he said that the Community would need to provide Britain with unlimited aid to withstand the anticipated outflow of reserves. The West Germans showed their willingness to meet British demands in part, but the amount that Bonn offered fell short. The British appreciated the "unbelievably generous" offer from Bonn–an FCO staffer remarked that it "really [was] an opportunity for us to get us out of the straight-jacket that has been imposed upon us ever since the War by the sterling balances." Treasury remained skeptical, however, that the West German offer was sufficient to put its fears at rest. Drawing on the recent memory of the June 1972 sterling crisis, Treasury feared that without an unlimited guarantee of aid, Britain would lose reserves quickly, particularly with sterling near the bottom of the Snake. J.O. Wright, "International Currency Crisis," March 2, 1973, UKNA, FCO 59/855.

grounds that it would be more difficult for Moscow to exercise control over an individual country if that country were integrated into a regional bloc. The rise of European economic power, however, gave the Nixon administration pause. While discussing the potential of the Community's joint float in March 1973, Kissinger said, "I'm no longer sure that European integration is all that much in our interest." Nixon responded, "Oh, I'm not so sure of it at all."[145] "We must act effectively and soon or we will create in Europe a Frankenstein monster, which could prove to be highly detrimental to our interests in the years ahead," Kissinger feared.[146] Shultz, however, greeted the Community float against the dollar as a step in the right direction toward "a liberal approach to world trade" and away from the anachronistic rigidity of Bretton Woods.[147] He did not regret the collapse of a system that required the U.S. to intervene in the market to protect the par value of the dollar. "Santa Claus is dead," he said.[148]

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The dollar crisis of March 1973 signaled the end of the Bretton Woods system, inaugurating the march toward flexible exchange rates after more than a quarter century of fixed parities.[149] As an integral part of the *pax Americana*, Bretton Woods had assisted the United States in maintaining economic leadership over its allies in Europe and Asia. After spring 1973, the United States remained the most powerful economic country in the world, but the end of

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[145] "Conversation Among President Nixon, the President's Assistant for National Security Affairs (Kissinger), and Secretary of the Treasury," March 3, 1973, *FRUS, 1969-1976, Vol. 31, Foreign Economic Policy, 1973-1976*, doc. 17. See also "Vermerk über Vier-Augen-Gespräch mit Sekretar George Shultz am 9. März und am 15. März," 30 März 1973, AdsD, Willy Brandt Archiv, A8/18.
[146] "Draft Memorandum From President Nixon to the President's Assistant for National Security Affairs (Kissinger)," March 10, 1973, *FRUS, 1969-1976, Vol. 31, Foreign Economic Policy, 1973-1976*, doc. 31.
[147] "Telegram From the Department of State to the Mission to the European Community," March 19, 1973, *FRUS, 1969-1976, Vol. 31, Foreign Economic Policy, 1973-1976*, doc. 37.
[148] Herring, *From Colony to Superpower*, 783.
[149] As James notes, the system that emerged after March 1973 was a "non-system" in which currencies either floated freely; fixed to the dollar, franc, or sterling; or floated as a unit. James, *International Monetary Cooperation After Bretton Woods*, 258.

Bretton Woods forced Washington to cede part of its hegemonic position. Reflecting on the monetary crises of the late 1960s and early 1970s, Schmidt argued in his memoirs that "monetary policy *is* foreign policy. The United States surrendered the leadership of monetary policy, and thus in practice some of its *de facto* leadership of the West."[150]

The collapse of Bretton Woods accelerated movement toward a "tripolarization" of the Western world. Combined with the rise of the Community and Japan as economic powers in their own right, economic malaise and inflation, the political fallout over the end of the Vietnam War and Christmas bombings, and changes in superpower relations, the industrial democracies found themselves at a crossroads. As Cold War tensions lowered in the era of détente, fear of the Soviet Union no longer united the industrial democracies. In September 1972, Kissinger told FRG Foreign Minister Walter Scheel "The concept of partnership must be given context. This content had been provided during the 1960's by the defense element. Now, in an era of change, this was not enough. Some new themes on which to work together must be found."[151]

The so-called "Year of Europe" initiative in spring 1973 represented Kissinger's first attempt to provide a new unifying theme to transatlantic relations.[152] In a speech at the Waldorf-Astoria hotel in New York on April 23, 1973, Kissinger proclaimed that the conditions in the international system required a "new era of creativity in the West" analogous to that Franklin D. Roosevelt and Winston Churchill had begun in August 1941 through the Atlantic Charter. Fear of the Soviet Union no longer united the industrial democracies, and they should find unity in

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[150] Helmut Schmidt, *Men and Powers: A Political Retrospective,* tr. Ruth Hein (New York: Random House, 1989), 158.
[151] Hillenbrand (Berlin) to Washington, "Scheel-Kissinger Conversation," September 12, 1972, NARA, RG 59 Subject Numeric Files, 1970-73, Political & Defense, POL 7 US/Kissinger 4/6/72, Box 2693.
[152] Kissinger's second (and far more successful) attempt was the use of consumer solidarity in the aftermath of the oil crisis of 1973-1974, a theme that will be addressed in the following chapter.

shared ideals and common interests. He pressed the Community to recognize the interdependence of U.S. and European interests in the realms of security and economics.[153]

Although Kissinger expected a response "similar to that [after] the announcement of the Marshall Plan," the speech actually served to strengthen European unity at the expense of the transatlantic relationship.[154] French policymakers scoffed at Kissinger's speech. Most senior French officials agreed with Foreign Minister Michel Jobert: "What business is it of his!"[155] They saw the Year of Europe as a presumptuous attempt to reassert U.S. hegemony over Community affairs in an age when Washington's influence declined and the self-confidence and independence of the Community grew. The cool and "skeptical" British and West German responses to the Year of Europe better represented the division between the United States and the Community.[156] Reeling from the collapse of Bretton Woods and searching for direction in transatlantic relations, the industrial democracies stumbled toward the oil crisis in October 1973.

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[153] The text of the speech can be found here: http://www.cvce.eu/content/publication/2002/9/30/dec472e3-9dff-4c06-ad8d-d3fab7e13f9f/publishable_en.pdf.
[154] Möckli, "Asserting Europe's Distinct Identity: The EC Nine and Kissinger's Year of Europe," in *The Strained Alliance*, 196.
[155] Aurélie Èlisa Gfeller, *Building a European Identity: France, the United States, and the Oil Shock, 1973-1974* (New York: Berghahn Books, 2012), 30.
[156] Referat 204, "Zusammenfassung und Wertung der Rede von Dr. Kissinger vom 23. April 1973," April 23, 1973, PA-AA, B 32 (ZA), 101383.

Chapter 2

“A Major Departure from the Autarkic Development Model”: When the East Reentered the Global Economy, 1968-1973

As East German policymakers drafted the country’s Five-Year Plan to launch in 1971, they charted an ambitious developmental path. Shortages of consumer goods and energy had caused mass discontent around the country in 1969 and 1970, and Socialist Unity Party (SED) regional bosses in *Bezirke* from East Berlin to Dresden reported popular dissatisfaction with existing economy policy. Industrial unrest in neighboring Poland in December 1970 served as a powerful lesson about the danger of labor unrest and consumer shortages to the socialist regime.[1] Desperate to avoid a repeat of the June 1953 Uprising in East Berlin, the SED leadership under new General Secretary Erich Honecker outlined a platform at the Eighth Party Congress in June 1971 that called for an expansive social program to satisfy their citizens, including raising pensions, a reduction in the number of mandatory hours in the work week, and a variety of other social services. In order to pay for this *Sozialpolitik*, the East Germans turned to the industrial democracies for technology and capital. The SED believed that if the country combined Western technology with superior socialist labor and relied on imported Soviet energy to fuel its Fordist factories, East Germany would be able to repay its debts quickly with the profits from high-quality exports.

The East German plan contained extraordinary risks. In particular, it exposed the country to conditions in the global capitalist economy to an unprecedented degree after spending the first two decades of its existence in the relative isolation of the socialist economic bloc–the Council of Mutual Economic Assistance (CMEA). Unfortunately for East Berlin, developments in global

[1] Jeffrey Kopstein, *The Politics of Economic Decline in Germany, 1945-1989* (Chapel Hill, NC: University of North Carolina Press, 1997), 69.

capitalism did not favor the SED plan. Instability in the international monetary system and upheaval in the global commodities markets made the achievement of East German goals difficult. As inflation increased rapidly in the industrial democracies, Chairman of the State Planning Commission Gerhard Schürer worried about its effect on the East German balance of payments. He calculated that the "inflationary development of prices in the capitalist countries" alone added an additional VM (Valuta-Mark) 1 billion to the East German deficit, a figure that took into account higher export prices.[2] East Germany also imported commodities from the developing world. Purchases of these materials in 1972 cost VM 1.8 billion more than they had in 1968–an increase of more than three times.[3] To make matters worse, the Soviet Union–on whose oil and natural gas reserves East Germany depended to power its factories–stood on the threshold of an energy crisis. Soviet officials informed their East German counterparts that they could not meet the rising demand in Eastern Europe. As a result, the East Germans had to import energy from the oil producers in the global South, using their limited reserves of hard currency to pay the rising world market prices.

Scholars tend to view the economic disruptions of the 1970s–including the collapse of the Bretton Woods international monetary system, the oil crises, and rise of global financial markets–as disruptions that did not significantly impact the Eastern bloc. Policymakers in the industrial democracies feared the consequences of accelerating economic interdependence, a process that eliminated the certainties of the postwar economic order based on fixed exchange rates, national markets, and access to cheap raw materials in the global South. This chapter

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[2] Gerhard Schürer, "Gegenwärtiger Stand und Probleme der Ausarbeitung des Volkswirtschaftsplanes 1974," November 7, 1973, Bundesarchiv Berlin-Lichterfelde (BAB), Berlin, Germany, DE 1/58701. The VM (Valuta-Mark) was the GDR's foreign trade bookkeeping currency and equal to one West German Mark (DM). During this period, $1 equaled about VM 2.5.

[3] "Auswirkungen der Preisentwicklung von Rohstoffen und Materialien auf dem kapitalistischen Weltmarkt auf den Import der DDR," May 31, 1973, Stiftung Archiv der Parteien und Massenorganisationen der DDR im Bundesarchiv (SAMPO), Berlin, Germany, DY 30/J IV 2/2J/4717.

contends that the Eastern bloc also had to confront these challenges. Developments such as runaway inflation, the new constellation of power in the energy markets, and the emergence of global financial markets had ramifications that transcended the ideological and geopolitical division of Europe, and officials in the Soviet Union and Eastern Europe had to adapt to global capitalism in transition.[4] This chapter proposes economic globalization as a framework that yields a unified history of the economic disruptions in the 1970s in the industrial global North, demonstrating how the global shocks posed challenges to policymakers on both sides of the Iron Curtain and forced them to confront changes in the structure of international economics.[5]

This chapter identifies a point at which the Soviet Union and its Eastern European allies emerged from relative isolation and reengaged the West to compensate for internal failings. The years 1968-1973 represented the point at which the Eastern bloc "reentered" the global economy and became vulnerable once again to the logic of the capitalist world market. These years marked the pivot when economic engagement with the capitalist world became unavoidable, and ultimately destabilizing. Policymakers across the Eastern bloc recognized that autarky was unsustainable because they had reached the limits of extensive growth, which refers to growth achieved by increasing resource inputs. In order to turn to intensive growth, which refers to growth achieved by increasing the quality of products, they increasingly believed that socialism needed reinvigoration through significant imports of technology and capital from the non-socialist world. They expected that this dependence would be temporary; the combination of

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[4] "Eastern Europe" refers to the members of the Council for Mutual Economic Assistance in the region, including Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Romania. Albania left CMEA in 1961. Non-Eastern European countries also joined CMEA over the course of the Cold War, including Cuba, Mongolia, and Vietnam, but this chapter will focus on Eastern Europe–the heart of the Soviet informal empire.

[5] Jeremi Suri utilized a parallel framework to interrogate how internal unrest threatened the stability of the capitalist and socialist great powers alike. See *Power and Protest: Global Revolution and the Rise of Détente* (Cambridge, MA: Harvard University Press, 2003).

Western materials and superior socialist labor would allow the Eastern Europeans to develop their own industrial base that could compete with that of the industrial democracies.

This chapter contends that the forces of economic globalization deeply affected the socialist states because they eschewed autarky almost precisely when the economic shocks began to erupt. The Eastern bloc did adapt to their economic stagnation, but the socialists collectively selected a path that placed them in a state of dependence on the non-socialist world to survive. The decision to engage the capitalists came from both a sense of vulnerability as well as strength. They understood that they were losing the standard of living competition with the industrial democracies, but they also were confident in their future success because of their view of the course of history as well as the contemporaneous economic upheaval that the West currently experienced. The socialists expected to regain their independence within a decade after they enjoyed the fruits of the infusion of Western capital and technology into their economies. The strategy ultimately failed for reasons that the following two chapters will illuminate.

The purpose of this chapter is to examine why the socialist bloc abandoned autarky in favor of engagement with global capitalism, focusing on the period from the first Soviet natural gas agreement with Austria in June 1968 to the eve of the first global oil shock in October 1973. The chapter unfolds in four parts. First, it examines why the Soviet Union oversaw a largely autarkic economic bloc in Eastern Europe for the first two decades of the Cold War. Second, it considers why the socialist bloc decided to abandon autarky and seek closer ties with the industrial democracies, focusing in particular on the struggles of the Soviet energy industry in the late 1960s. Third, it illuminates why the industrial democracies were receptive to Soviet overtures to establishing long-term business relations. Finally, this chapter illuminates the connection between the crisis in the Soviet energy industry and the development of the Eastern

European import-led growth economic plans. By October 1973, the Eastern bloc had become vulnerable to the threats and opportunities of economic globalization.

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The Eastern bloc embarked on an autarkic path of economic development during the early Cold War, seeking to utilize the collective resources of the socialist states through central planning.[6] Devastated by the carnage of the Great Patriotic War, the Soviet Union initially viewed the extraction of reparations from occupied-Eastern Europe–particularly Hungary, Romania, and its zone in eastern Germany–as a path to rebuild its shattered economy.[7] Aside from exploiting Eastern Europe economically, Stalin initially did not know how he should treat the region.[8] By 1947, he began consolidating a Soviet-led bloc in the context of heightened fears about his hold over the region. Stalin saw enemies across Europe who challenged his authority. Yugoslav leader Josip Broz Tito, for example, displayed increasing independence from Moscow and communists suffered setbacks in France, Italy, and Greece. The United States moved forward on plans to integrate its occupation zone of Germany with the West. Then the U.S. Secretary of State George C. Marshall announced in June 1947 that the United States would offer aid to the devastated economies of Europe, an offer that Soviet Foreign Minister Vyacheslav

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[6] This interpretation stands in opposition to the work of Oscar Sanchez-Sibony, who contends that the Soviet Union constantly sought to engage global capitalism. See *Red Globalization: The Political Economy of the Soviet Cold War from Stalin to Khrushchev* (Cambridge: Cambridge University Press, 2014).

[7] On the Soviet exploitation of eastern Germany, see Norman Naimark, *The Russians in Germany: A History of the Soviet Zone of Occupation, 1945-1949* (Cambridge, MA: The Belknap Press of Harvard University Press, 1995), 141-204. On the transition from National Socialism to central planning, see Burghard Ciesla, "Winner Takes All: The Soviet Union and the Beginning of Central Planning in Eastern Germany, 1945-1949," in *The East German Economy, 1945-2010*, ed. Harmut Berghoff and Uta Andrea Balbier (Washington, DC: German Historical Institute; and New York: Cambridge University Press, 2013), 53-75.

[8] The defeat of Nazism increased the prestige of the Soviet Union as well as the viability of socialism, but the Soviets moved slowly at first in Eastern Europe. They remembered the violent defeats of fledgling socialist states in the aftermath of the First World War in places such as Hungary and Bavaria, developments that made communism deeply unpopular during the interwar years; the communist party was outlawed in every Eastern European country except Czechoslovakia. Stalin also did not want to provoke the West by moving too quickly in the region. He supported "people's democracies" in Eastern Europe and allowed coalition governments, only cracking down when his perception of threat increased.

Molotov denounced as a nefarious American plot to gain control of the Soviet sphere of influence. The Soviets had already spurned the Bretton Woods international monetary system in December 1945, and there was little incentive to cooperate economically with the West. Stalin forbade the Eastern Europeans from participating.

As a means of consolidating the Soviet sphere of influence in the face of perceived threats, the Soviets convened a meeting in September 1947 in Poland at Szklarska Poręba to unite the communist parties of Europe. Under the leadership of Andrei Zhdanov, they established a new organization–the Communist Information Bureau (Cominform)–to maintain ideological cohesion under Soviet oversight.[9] Moscow instructed communists in Bulgaria, Romania, and Hungary to crack down on their opponents, and the Soviets exploited a crisis in February 1948 in Czechoslovakia to help communists take control of the government in a coup d'état.[10] After the experiences of the two world wars and Western intervention in the Russian Civil War, Stalin wanted an ideologically-coherent buffer zone in Eastern Europe that would protect against yet another invasion from the West.

The economic component of the sovietization of Eastern Europe followed shortly thereafter. The new socialist states coordinated their economies through the Council for Mutual Economic Assistance (CMEA), an organization founded in January 1949 to promote Eastern European economic integration with the Soviet Union. Each of the Eastern European countries embarked on five-year plans for rapid industrialization, nationalization of industry, purge of capitalist elements, a higher standard of living for their people, and intimate economic ties with

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[9] On Zhdanov, the origins of the Cominform, and the consolidation of Soviet control over Eastern Europe, see Vladislav Zubok and Constantine Pleshakov, *Inside the Kremlin's Cold War: From Stalin to Khrushchev* (Cambridge, MA: Harvard University Press, 1996), 125-37.
[10] For a summary of this process, see Norman M. Naimark, "The Sovietization of Eastern Europe, 1944-1953," in *The Cambridge History of the Cold War, Volume 1: Origins*, ed. Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), 175-97.

Moscow. They developed command economies in which the government controlled virtually all power and means of production. Socialists considered Soviet industrialization and social organization in Stalin's "revolution from above" during the 1930s as the paradigm for how their own states should proceed; in his memoirs, Bulgarian General Secretary observed, "It was no coincidence that especially in the first years of our socialist development, almost all of our steps necessarily had to take into account the Soviet experience."[11] Eastern European policymakers also viewed their economic plans as a form of opposition to the capitalist West. The U.S. pursued a "policy of isolation, boycott and economic blockade" of the East, Czechoslovak Prime Minister Antonín Zápotocký told his countrymen in October 1948, but Washington "cannot arrest the constructive work of building up our economy, nor our progress towards socialism."[12] Central planning did not accord easily with foreign trade, but CMEA embraced the concept of the "socialist division of labor" in which each country specialized in particular products.

As the sovietization of Eastern Europe accelerated in the 1950s, Moscow shifted from a policy of exploitation to subsidization. With its responsibility as the regional hegemon, the Soviet Union had vast reserves of natural resources and raw materials to exchange for machinery and manufactured goods from its Eastern European allies. The historian Tony Judt observes that this arrangement represented a "curious inversion" of European overseas colonization: the imperial power (USSR) provided the raw materials and the colonies (Eastern Europe) supplied the prepared goods. The system deformed the Eastern European economies. Moscow assigned agricultural roles to countries such as Romania and Bulgaria, retarding their ability to develop a manufacturing base. Countries such as East Germany, Hungary, and Czechoslovakia focused on

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[11] Todor Zhivkov, *Memoari* (Sofia: Izdatelstvo IK "Trud i pravo," 2006), 459.
[12] Antonín Zápotocký, Address to the Czechoslovak National Assembly, October 7, 1948, in *The First Czechoslovak Economic Five-Year Plan* (Prague: Czechoslovak Ministry of Information and Public Culture, 1948), 21.

industrial goods, but Soviet-style rapid industrialization did not make sense in countries with a skilled workforce. Czechoslovakia, for example, did not have the seemingly endless reserves of unskilled laborers that the Soviet Union had in the 1930s, but the country did have a highly skilled workforce and a tradition of exporting quality goods to the West. The industrial Czech regions of Bohemia and Moravia had a higher per capital output than France before the First World War, with a reputation for superior quality leather goods, automobiles, weapons, and luxury goods. On the eve of the Second World War, Czechoslovakia was comparable to Belgium and ahead of Italy and Austria in terms of industrial skill levels, productivity, standard of living, and share of foreign markets. By 1956, however, Czechoslovakia had fallen behind all of Western Europe and was poorer and less productive than it had been just two decades prior. Focusing on manufacturing steel (Czechoslovakia had few domestic reserves of iron ore) was, as Judt notes, "enforced backwardness."[13] This system resulted in a high level of mutual economic dependence within CMEA, particularly on the Soviet Union, a development that provided Moscow an important tool to control its allies.

CMEA conducted its internal trade in "valuta rubles," a unit of account that was used for clearances within CMEA but had no value outside of the bloc. Soviet authorities set the official exchange rate in 1961 at $1.11 per ruble, a nominal conversion that ended after the decoupling of the U.S. dollar to gold in 1971. Thereafter, the ruble was linked to a basket of Western currencies and fluctuated to match the turbulence of Western monetary instability in the 1970s. The ruble was not traded on international financial markets and was used only for accountancy purposes. After purchasing goods in convertible currency from the West, the Soviet Ministry of Trade, for example, would sell them to Soviet consumers, who would buy the goods at the domestic price

[13] Tony Judt, *Postwar: A History of Europe Since 1945* (New York: Penguin, 2006), 171-72.

for the closest Soviet substitute of the product. The domestic Soviet price system was fixed arbitrarily and failed to provide a useful guide for Soviet policymakers to optimize foreign trade. The process of making world prices legible in the socialist bloc was known by its German name: *Preisausgleich*.[14]

Calculating socialist economic performance is notoriously difficult, but all estimates indicate high growth rates in the region in the postwar period as each member concentrated on extensive growth.[15] Between 1950 and 1960, GDP grew about 5.2 percent in the Soviet Union and 5.1 percent in Eastern Europe. The following decade, the rates were approximately 4.8 percent in the Soviet Union and 4.3 percent in Eastern Europe. These numbers compared favorably to the corresponding figures for the United States and Western Europe, albeit from a much lower starting point.[16] Much of this growth, however, came from the one-time benefits of rapid industrialization, unsustainable levels of growth that petered out after the limits of extensive growth had been reached.

The development of the Soviet energy industry and extensive growth in the Eastern bloc were intimately intertwined. The exploitation of recently-discovered oil and natural gas fields in western Siberia drove Eastern European economic growth in the 1950s and 1960s, allowing the members of CMEA to achieve levels of growth that compared favorably to other parts of the world. "With the construction of the oil pipeline 'Druzhba,' the creation of the system of natural gas pipelines, and the development of freight depots by the European members [of CMEA], the important plans [of economic development] were quickly realized," Schürer later wrote.[17]

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[14] Alan Smith, *Russia and the World Economy: Problems of Integration* (New York: Routledge, 1993), 45-48.
[15] Extensive growth refers to the increase in inputs of labor and capital.
[16] Richard N. Cooper, "Economic Aspects of the Cold War, 1962-1975," in *The Cambridge History of the Cold War, Volume I1: Crises and Détente*, ed. Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), 49.
[17] Gerhard Schürer, *Gewagt und Verloren: Eine Deutsche Biographie* (Frankfurt: Frankfurter Oder Editionen, 1996), 205.

Production in the early years of the Soviet Union had focused on the oil-rich areas of Azerbaijan, particularly in the region of Baku. Recognizing the tremendous value of the Soviet oil fields, conquest of Baku had ranked among Adolf Hitler's highest priorities on the Eastern Front.[18] The postwar reconstruction of the Soviet oil industry proceeded quickly after the defeat of Nazi Germany, but production in Baku never returned to its prewar levels. The Soviets instead moved north into the rich and undeveloped Volga-Ural region. Geologists also surveyed the remote areas of Siberia, identifying significant reserves.[19] Between 1955 and 1960, Soviet oil output doubled, and by the end of the 1950s, the Soviet Union surpassed Venezuela as the second largest oil producer in the world.[20] By 1975, the Soviet Union had become the world's leading oil producer, wrestling the title away from the United States. The Eastern Europeans paid a bit more for Soviet oil imports than they would have on the world market. East Berlin calculated that in 1970, for example, it paid 30.2 million rubles more for Soviet oil than it would have spent for the same amount of oil from non-socialist producers.[21] This was offset, however, because the Soviets purchased Eastern European goods at prices far higher than they would have received elsewhere.

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[18] On the growing oil and coal crises in Nazi Germany on the eve of Barbarossa and their impact on Hitler's strategic thinking, see Adam Tooze, *The Wages of Destruction: The Making and Breaking of the Nazi Economy* (New York: Penguin, 2006), 411-25. Stalin expected Hitler to attempt to seize the oil fields of the Caucuses, particularly the Baku fields. A young deputy oil commissar in Azerbaijan for most of the "Great Patriotic War," Nikolai Baibakov worked in the oil fields produce fuel for the war effort against Nazi Germany. In July 1942, as the Wehrmacht approached Baku, Stalin called Baibakov to Moscow and warned that the war would be lost if the Germans seized control of the oil in the Caucasus. "You will be shot if the Germans get their hands on even a ton of oil," Stalin said. "If you destroy the production facilities and the Germans don't come, you will also be shot because then we will have no oil." When Baibakov asked whether he had an alternative to this assignment, Stalin answered, "Do you really think you have one, young man?" Fortunately for Baibakov, the Red Army repelled the German invaders and production returned to prewar levels by 1946. The slow acceleration of production and the high demand in the country meant that the Soviet Union was a net importer of oil until 1953, mostly from Romania. The quotation is reproduced in Schürer, *Gewagt und Verloren*, 184.

[19] Marshall I. Goldman, *Petrostate: Putin, Power, and the New Russia* (New York: Oxford University Press, 2008), 17-32.

[20] Daniel Yergin*, The Prize: The Epic Quest for Oil, Money & Power* (New York: Free Press, 1991), 497.

[21] No author, "Aufwendungen für den Import von Erdöl und Erdgas aus der UdSSR 1970-1977," June 30, 1977, BAB, DE 1/58544.

Natural gas production and consumption also rose quickly. The Central Committee of the CPSU and Council of Ministers resolved in August 1958 to embark on an ambitious program to develop the natural gas industry to become a key contributor to the country's energy supply. Total production in 1958 totaled 30 billion cubic meters in 1958, but Soviet policymakers aimed to boost this figure tenfold within fifteen years. "No other branch of the national economy, not even in our country, has ever known of such growth rates," the new Ministry of Gas Industry Director Alexei Kortunov crowed.[22] In February 1970, Kortunov reported to the Council of Ministers that about half of Soviet citizens who lived in cities had access to natural gas in 1970, compared to under a third just five years prior. Since 1965, the number of gasified apartments in the USSR doubled. Identified reserves exceeded 12 trillion cubic meters. "Our country has firmly taken its place in the world by virtue of the presence of our enormous resources," Kortunov wrote. "All of the tasks called for [in the resolution of 1958] have already been completed."[23]

External conditions in the international system accelerated Soviet economic integration with Eastern Europe and limited CMEA's engagement with the capitalist world. First, the rise of the Sino-Soviet antagonism in the late 1950s and early 1960s allowed Beijing to emerge as a challenger to Moscow as the leader of global socialism, and Moscow saw further economic integration with Eastern Europe as a tactic to tie the region securely to the Soviet Union.[24] Moscow tolerated a degree of independence, but interventions during the Hungarian Revolution in 1956 and Prague Spring in 1968 demonstrated that there were limits to what Moscow would

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[22] Högselius, *Red Gas*, 18.
[23] Alexei Kortunov to the Council of Ministers, February 26, 1970, f. 458, op. 1, d. 2047.
[24] This fear was made more portentous when Albania severed relations with the Soviet Union and joined the Chinese camp. On the economic roots of the Sino-Soviet split, see Lorenz M. Lüthi, *The Sino-Soviet Split: Cold War in the Communist World* (Princeton, NJ: Princeton University Press, 2008), 41-44.

allow.[25] Second, the *Wirtschaftswunder* in West Germany and the launch of the European Economic Community in 1957 provided a successful economic model on Eastern Europe's doorstep. Further socialist integration seemed to offer a solution for Moscow to balance the economic challenge from Western Europe.[26] Finally, the socialist promotion of self-sufficiency coincided with Western efforts to isolate the Eastern bloc. In late 1947, the United States tightened export controls of material to the Soviet Union as well as its allies, calling for close scrutiny of shipments of industrial materials and equipment to the Eastern bloc that could have direct or indirect application in the Soviet military industry. Washington wielded influence over Western trade policy with the Eastern bloc through the Coordinating Committee for Multilateral Export Controls (COCOM), an organization that created a list of goods that the industrial democracies could not export to the socialists.[27] West Germany's isolation of East Germany reinforced this policy. Bonn did not recognize East Germany as a legitimate state and refused to maintain diplomatic relations with any country that did, a policy known as the Hallstein Doctrine. West Germany launched a campaign in the 1950s to deny East Germany international recognition around the globe by offering economic incentives to those who recognized only Bonn.[28]

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[25] Although these events were driven in part by the desire to distance from Moscow, the protesters wanted to reform the socialist system, not abolish it. See, for example, Charles Gati, *Failed Illusions: Moscow, Washington, and Budapest, and the 1956 Hungarian Revolt* (Washington, DC: Woodrow Wilson Center Press, 2006).
[26] Randall W. Stone, *Satellites and Commissars: Strategy and Conflict in the Politics of Soviet-Bloc Trade* (Princeton, NJ: Princeton University Press, 1996), 33.
[27] On U.S. policy in COCOM and Washington's problems with convincing the Western Europeans to fall in line, see Michael Mastanduno, *Economic Containment: CoCom and the Politics of East-West Trade* (Ithaca, NY: Cornell University Press, 1992).
[28] On this issue, see William Glenn Gray, *Germany's Cold War: The Global Campaign to Isolate East Germany, 1949-1969* (Chapel Hill, NC: University of North Carolina Press, 2003). In official documents, West German policymakers referred to East Germany as the "Zone." Bonn followed a policy of *Alleinvertretungsanspruch*–the claim that West Germany spoke for all of Germany as the only legitimate government. The other industrial democracies supported the broad outlines of the Hallstein Doctrine in order to assure West German cooperation on other matters.

In practice, CMEA's pursuit of autarky in the first half of the Cold War did not mean total disengagement from the global economy. CMEA retained non-essential commercial relations with the West and the developing world. As Soviet energy production accelerated and outpaced demand in the socialist bloc, for example, Moscow found buyers for its surplus in Western Europe, particularly Italy. Western Europe was generally less dogmatic than the United States about isolating CMEA, and even the United States had trade agreements with the Soviets, particularly in the agricultural sector. A U.S. interagency study estimated that in 1967, the Eastern bloc imported $6.5 billion worth of goods from the free world and exported $6.8 billion (OECD constituted $3.9 billion and $4.2 billion, respectively, of those totals).[29] In that year, Czechoslovakia and Poland were already members of General Agreement on Tariffs and Trade (GATT), with Romania and Hungary well on their way to membership as well. Commercial relationships also became a useful tool in Moscow's relationship with the developing world.[30]

Nevertheless, the emphasis in the bloc remained on socialist integration. The trade deals with the rest of the world did not constitute long-term relationships; they took place on the spot market, and the relationships fluctuated based on the political context. Socialist policymakers viewed the relatively small volume of trade with the industrial democracies as a temporary evil, trade that would become superfluous after the socialist economies developed and surpassed capitalism.

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[29] National Security Study Memorandum, "NSSM 35: Trade Policy Toward Communist Countries," May 12, 1969, Richard M. Nixon Presidential Library (RNPL), Yorba Linda, CA, National Security Council Institutional Files, Review Group: Trade Policy Toward Communist Countries 5/12/69, Box H-36

[30] See, for example, Nicola Miller, *Soviet Relations with Latin America, 1959-1987* (New York: Cambridge University Press, 1989).

By the late 1960s, however, the Eastern bloc abandoned autarky in favor of engagement with the global economy. The emphasis on extensive growth ran out of steam; socialism failed to surpass capitalism. In his memoirs, Bulgarian Chairman of the Council of Ministers Stanko Todorov remembered that in the second half of the 1960s, economic growth slowed. "The economy should be oriented from an extensive to an intensive type of development," he wrote. "With quality output, we could gain wider access to world markets, which comported with political détente in the world."[31] Socialism had promised a higher standard of living but had not yet delivered. In October 1971, Schürer admitted, "There is a fundamental divergence between raising the material and cultural standard of living, and the necessary conditions to achieve this, including high productivity and effectiveness."[32] Fearing the growing division between Western and Eastern economies (even as the industrial democracies faced their own significant problems), the socialists needed to change course to avoid social unrest. Policymakers across the Eastern bloc reluctantly turned to the non-socialist world to compensate for their technological, energy, and financial shortcomings.

A chief reason for the concern in the Eastern bloc was the inability of the Soviet energy industry to satisfy the growing demand within CMEA. Production increased quickly, but demand rose more rapidly. The emerging crisis was a component of a larger energy problem sweeping the globe, as developed and developing countries alike grappled with the implications of skyrocketing demand as economies modernized and required an expanding supply. Scholars tend to focus on the non-socialist world in their analyses of the origins of the 1973 oil crisis, but the socialist countries suffered from a similar predicament. "Problem number one," Baibakov

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[31] Todorov, *Do Varkhovete na Vlastta*, 129-30.
[32] Staatliche Plankommission, "Persönliche Notizen über die Beratung der Parteigruppe des Ministerrates am 11.10.1971," October 12, 1971, BAB, DE 1/54544.

remarked in December 1972, “was securing the necessary fuel and energy to supply the rising demand.”[33] Soviet officials privately began to worry about this in the early 1970s and anxiety grew quickly.[34]

Several supply-side problems hindered the development of the Soviet energy industry. The Soviets lacked the means to develop the country’s resources efficiently, a phenomenon that political scientist Thane Gustafson calls “crisis amid plenty” and economist Marshall Goldman labels the “enigma of Soviet petroleum.”[35] Performance in oil-producing areas such as Baku and the Volga-Ural region decreased much faster than officials had anticipated, and the Ministry of Oil neglected to develop the enormous reserves in western Siberia. Soviet geologists first discovered oil reserves there in 1953, but institutional inertia and the logistical challenges of moving the production infrastructure away from consumers in the European regions of the USSR meant development in western Siberia lagged.[36] By the mid-1970s, more than two-thirds of new reserves that Soviet geologists identified were located in western Siberia, but only about 15 percent of the investment in the country-wide drilling effort to extract oil went to projects in the region.[37]

The isolation of the region required that the Soviets develop infrastructure from scratch. The British Foreign and Commonwealth Office estimated that building only one mile of road in

[33] Gerhard Schürer, “Information über die Beratungen in Moskau am 8. und 9.1972,” December 11, 1972, BAB, DE 1/58701.
[34] This chapter argues that internal concern about the shortcomings of the Soviet energy industry occurred before the 1973 oil crisis. In contrast, Thane Gustafson, who did not have access to archival sources and had to rely on the public record, identifies the mid 1970s as the point at which “energy had finally become an issue in the Kremlin.” Thane Gustafson, *Crisis Among Plenty: The Politics of Soviet Energy Under Brezhnev and Gorbachev* (Princeton, NJ: Princeton University Press, 1989), 27.
[35] Gustafson, *Crisis Among Plenty* and Marshall I. Goldman, *The Enigma of Soviet Petroleum: Half-Full or Half-Empty?* (London: George Allen & Unwin, 1980.
[36] For a breakdown of envisioned production in the 1970s by region, see Yu. Bokserman to G.V. Krasnikovskomu (predsedatelyu Gasekspertizy Gosplana SSSR), February 23, 1970, Rossiiskii gosudarstvennyi arkhiv ekonomiki (RGAE), Moscow, Russia, f. 458, op. 1, d. 2047.
[37] Gustafson, *Crisis Among Plenty*, 73-77.

Siberia would cost $500,000. The under-population of western Siberia presented "an almost intractable problem," and Soviet policymakers had little success using material incentives to convince immigrants to relocate to the harsh climate of Siberia.[38] The summers were unbearably hot and humid. Baibakov later wrote, "The tundra, bogs, swamps…It's one thing to hear about that or see it in the cinema or magazines, but it's quite different to experience it yourself….I still remember the attacks of gnats and midges from which neither mosquito nets nor fumigators saved." After touring the reserves in Siberia, the Czechoslovak State Planning Commissioner Václav Hula sent Baibakov a big carton of insect repellent on which Hula placed a label: "anti-Tyumen."[39] Operating conditions in Tyumen during the winter posed the opposite problem: temperatures occasionally fell for weeks below -45 degrees Celsius. Kosygin told Schürer in February 1973 that on his most recent visit to Tyumen, temperatures even reached -60 degrees Celsius, leading to burst pipes and other accidents.[40] In the winter the earth froze to depths of 300-500 meters, posing significant challenges for surveys and pipeline construction. The Soviet oil industry journal, *Neftyanik*, concluded that the exploitation of Siberian reserves was "comparable to the complexities of space research."[41]

In addition to working in the unforgiving regions of western Siberia, the Ministry of Gas Industry faced the difficult task of transporting gas over thousands of kilometers to consumers and distributors far to the west, traversing rugged terrain. "The relocation of gas production centers to the harsh climatic and mining-geological regions, which are located at a considerable distance from the main gas-consuming systems, hinders the growth rates of gas production to a

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[38] "Summary and Conclusions of the Round Table on Siberia's Natural Resources," February 27, 1974, United Kingdom National Archives (UKNA), Kew, England, FCO 28/2609.
[39] See Nikolai Baibakov, *The Cause of My Life*, trans. Vladimir Bisengaliev (Moscow: Progress, 1986), 194.
[40] Gerhard Schürer, "Information über ein Gespräch mit Genossen Kossygin am 1.2.1973," February 2, 1973, BAB, DE 1/58701.
[41] Quoted in "Siberia's 100-inch Pipelines," *Petroleum Press Service* 36, no. 10 (October 1969): 366

considerable extent," Kortunov's successor as Minister of Gas Industry Sabit A. Orudzhev wrote Kosygin.[42] The capital requirements were enormous. The development of the natural gas fields of Tyumen required a massive investment in large pipes and compressor stations that would link the gas fields to consumers in the west, but the Soviet Union lacked both the necessary capital and technology to do so quickly.[43] The system of pipelines (known as the "Northern" or "Severny" system) that would connect Siberia to the European regions of the Soviet Union and would consist of four parallel pipelines, each running west for more than 2,000 kilometers. The pipes would require the largest diameter in the world. Altogether, the Severny system would have a length of 23,000 kilometers, constructed at a price 7.8 billion rubles (equivalent to about £3.6 billion in 1969).[44]

Production of energy in the Soviet Union increased in the 1960s and 1970s, but it could not keep pace with the rising demand within CMEA.[45] Totaling about 350 million tons in 1970, the Soviets anticipated in the 1971-1975 Five-Year Plan raising production to 450-470 million tons in 1975 and another jump to 600-620 million by 1980.[46] Consumption levels rose more quickly, however. In the Soviet Union alone, consumption reached 368 million tons by 1975 (in comparison to 119 million in 1960 and 262 million in 1970).[47] Faced with technical and capital difficulties, the Soviets demanded that Eastern Europe take a larger part in developing Soviet reserves and collaborate in development efforts. "The USSR alone can no longer bear the burden

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[42] Memorandum from Sabit A. Orudzhev to Alexei Kosygin, September 18, 1974, RGAE, f. 458, op. 1, d. 3728.
[43] The use of liquefied natural gas (LNG), which could be transported by sea, was not seriously considered until later in the decade.
[44] "Siberia's 100-inch Pipelines," 369.
[45] Production in oil increased 176 percent from 1966-1970 and 1971-1975; production in natural gas increased 412 percent during the same period. Cited in Lee Kendall Metcalf, *The Council of Mutual Economic Assistance: The Failure of Reform* (New York: Columbia University Press, 1997), 87.
[46] "Russia Plans Its Future," *Petroleum Press Service* 37, No. 9 (September 1970): 321.
[47] Goldman, *The Enigma of Soviet Petroleum*, 75.

of developing raw materials," Chairman of Gosplan Pyotr Lomako warned in July 1965.[48] Difficulties with deliveries were not confined to exports; the Soviets had trouble supplying their own territories. Chairman of the Council of Ministers of the Latvian SSR Jurijs Rubenis wrote Moscow to stress that Latvia, which was not well integrated into the system of gas pipelines, only had enough resources to cover twenty percent of the republic's demand. Moscow had planned to connect Latvia to natural gas flows in 1965, but that date kept being pushed back.[49]

In the face of a looming crisis, the Soviets viewed access to Western technology and finance as a solution to their problems. The Soviet Union pursued energy deals with Western companies for several reasons. First, collaboration between Moscow and Western firms contributed to the spirit of détente in the late 1960s and early 1970s.[50] Second, the Soviet Union placed great importance on energy deals with Western Europe because energy exports constituted Moscow's greatest source of hard currency earnings (approximately 80 percent), which could be used to purchase manufactured goods and grain on the capitalist market.[51] Agriculture in particular became a chronic problem for Moscow. In 1972, for example, Kosygin explained to Eastern European officials that a combination of heat and drought led to a poor harvest. The regions on the Volga River, the northern Caucuses, and southern Ukraine performed particularly badly. The drought was so severe that in some cases, the Soviets had to supply water from remote areas by tankers and pipelines to needy people and livestock in places such as

[48] "Vorschläge der UdSSR für eine Investitionsbeteiligung der Mitgliedsländer des RGW bei der Entwicklung der Grundstoffindustrie der UdSSR," July 21, 1965, SAMPO, DY 30/7148.
[49] Memorandum from Yu. Ruben to A. Kortunov, April 12, 1971, RGAE, f. 458, op. 1, d. 2539.
[50] The Soviets generally proved receptive to West German overtures, with the exception of Foreign Secretary Andrei Gromyko who prioritized relations with Washington and enjoyed using West Germany as a "whipping boy" (*mal'chik dlya bit'ya*) to demonstrate his credentials as a champion of class struggle and anti-imperialism. Georgi Arbatov makes this contention in *Svidetel'stvo sovremennika: zatyanuvtseesya vyzdorovlenie (1953-1985 gg.)* (Moscow: Izdatelstvo mezhdunarodnye otnoshenia, 1991), 192.
[51] Gustafson, *Crisis Among Plenty*, 56.

Voronezh, Saratov, and Rostov.[52] The legacies of collectivization also played an important role. Imports from the West provided the means to compensate for Soviet agricultural shortages. Third, the Soviets also looked at their energy reserves as a matter of prestige. At the Moscow Summit in May 1972, for example, Brezhnev boasted to U.S. President Richard M. Nixon that the Soviet Union had the resources that would "make it possible to solve major problems for the U.S. in terms of large supplies of gas and oil, timber and other products."[53] "There will be a crisis…in the U.S. in a few years' time," Brezhnev said at another point. "We could have said to ourselves, to hell with them, let the Americans have a crisis. But instead we say, let us build a pipeline and let you have millions of barrels of gas."[54]

Most importantly, Western European firms could offer technical expertise and equipment to accelerate the development of remote reserves in western Siberia. An American interagency study projected that accelerated production of Soviet energy could boost Soviet hard currency earnings by about $55 billion over the period 1975-1990 through sales to the West. The study estimated that without outside assistance, the development of the Soviet energy industry would be delayed by three to five years.[55] Soviet planners saw cooperation with Western Europe as an attractive method to develop the vital but remote energy-producing regions in western Siberia. Orudzhev wrote that Tyumen's harsh climate made extraction exceptionally difficult and required a new generation of technology beyond existing Soviet capabilities. The task could only

[52] "Vermerk über ein Gespräch mit Genossen Kossygin am 12.7.1972," BAB, DE 1/58575.
[53] "Memorandum of Conversation," May 23, 1972, Foreign Relations of the United States, 1969-1976, vol. XIV, Soviet Union, October 1971-May 1972, ed. David C. Geyer, Nina D. Howland, and Kent Sieg (Washington, DC: United States Government Printing Office, 2006), doc. 259, 998. After boasting about Soviet advantages in raw materials, Kosygin interjected: "not to mention vodka." Brezhnev added, "America is indeed backward in vodka."
[54] "Memorandum of Conversation," April 22, 1972, Foreign Relations of the United States, 1969-1976, Vol. XIV, doc. 141, 550-51.
[55] "NSSM 214: Implications of U.S. Participation in Siberian Development," March 24, 1975, Gerald R. Ford Presidential Library, Ann Arbor, MI, National Security Adviser Files, NSC Europe, Canada, and Ocean Affairs Staff: Country Files, USSR-Siberian Development, 1975 (1) WH, Box 33. Treasury, Defense, and CIEP concurred with the findings of NSSM 214.

occur with "radical improvement of design and construction"–including the development of high-quality pipes of large size (1,420 mm) and compressor stations that could transmit gas at 75 atmospheres or higher.[56]

The Soviets did not have these in the requisite quality or quantity. Baibakov made this point to the Politburo in April 1972. At the meeting, Chairman of the Presidium of the Supreme Soviet Nikolai Podgorny worried that relying on the West would make the Soviets look "technologically helpless. Can't we do the same things ourselves, without foreign capital?!" Brezhnev asked Baibakov to respond to this question. Baibakov "calmly" took the microphone, "barely suppressing an ironic smile. And he began to speak, providing from memory dozens of numbers, calculations, and comparisons. Clearly and professionally." Baibakov said, "We have nothing to sell for hard currency. Only timber and pulp. This is not enough." Western companies wanted to build a pipeline from Tyumen to Murmansk and another from Vilyuysk to Magadan. "If we refused," Baibakov warned, "we will not be able to even approach the Vilyuysk reserves for at least 30 years…we have no metal for pipes, nor for machines or other equipment."[57] Soviet technology was advanced and the USSR was capable of producing high-quality equipment for the energy industry (this was, after all, the country that launched the first satellite into space in October 1957), but Moscow did not conceal the fact that the scale of the projects severely overwhelmed their resources.[58]

Opening up to the West stimulated debate about how increased ties with the capitalists corresponded to socialist ideology. The various crises afflicting the capitalist world during the late 1960s and early 1970s gave many in the Soviet Union and its allies confidence that increased

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[56] Memorandum from Sabit A. Orudzhev to Alexei Kosygin, September 18, 1974, RGAE, f. 458, op. 1, d. 3728; Gustafson, *Crisis Among Plenty*, 143-44.
[57] Diary of Anatoly S. Chernyaev, April 8, 1972, Digital National Security Archive (DNSA).
[58] "World's Biggest Gas Potential," *Petroleum Press Service* 37, No. 11 (November 1970), 400-1.

economic ties with the West would not undermine socialism. Despite their own economic struggles, they believed that political and economic conditions in the international system increasingly tilted in their favor. Hermann Axen–Director of the East German General Department of the Central Committee–pointed to the collapse of the Bretton Woods international monetary system and rising social and racial tensions in the industrial democracies as proof of the imminent collapse of capitalism. Rising economic and political tensions between the United States and Western Europe seemed to confirm the socialist expectation that the imperialists would turn against each other.[59] Soviet think tanks agreed, concluding that the United States and Western Europe "will develop into competitors and their differences will go on increasing."[60] Paul Markowski of the Department of Propaganda in April 1973 celebrated the U.S. acceptance of defeat and socialist victory in Vietnam as an indicator of the future trajectory in international relations. The signing of the Moscow, Warsaw, and Berlin Treaties in the early 1970s represented great victories for the Eastern bloc as the socialists won *de facto* recognition from West Germany of their borders. "The capitalists have gone on the defensive," he said. "They are losing in Europe, Asia, and Latin America…There is a deep crisis in imperialism."[61] In a June 1969 speech at the International Conference of Communist and Workers' Parties in Moscow, Zhivkov summarized: "The course of mankind's development today is determined not by

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[59] "Rede des Genossen H. Axen: Die Aufgaben der Sozialistischen Einheitspartei Deutschlands und der Deutschen Demokratischen Republik nach dem 8. Plenum des Zentralkomitees," February 15, 1973, SAMPO, DY 30/IV B 2/20/10.
[60] A. Snejdarek, the Director of the Czech Institute for International Affairs, summarized a 1968 Soviet study on the evolution of the capitalist world in the 1970s to Russ Fessenden, a U.S. diplomat in Bonn. The conclusions of the Soviet study are presented in Helmut Sonnenfeldt to Henry Kissinger, "Snejdarek Message to You," April 11, 1970, RNPL, NSC Files, Country Files–Europe, Country F. Log Europe, Germany, Vol. V [10 Apr 70–31 Jul 70], Box 683.
[61] Paul Markowski, "Die gemeinsame Aussenpolitik der sozialistischen Staatengemeinschaft zur Durchsetzung der friedlichen Koexistenz zwischen Staaten unterschiedlicher Gesellschäftsordnung," April 26, 1973, SAMPO, DY 30/IV B 2/20/10.

imperialism but by the common fight of…the world socialist system, the communist and workers' movement in the capitalist countries, [and] the national-liberation movement."[62]

Others saw trade with the West as a component of peaceful coexistence in the era of détente. Productive trade relations reinforced the reduction of political tensions. At a meeting with West German leaders in March 1976, Patolichev proclaimed that the Soviet Union had "never aspired to autarky, but on the contrary always advocated a broad international division of labor and cooperation." The division between the European Economic Community and CMEA bred "economic confrontation," which would "inevitably spread" to international politics. "We must look seriously look for ways to break existing economic groups," he concluded.[63]

Proponents also cast expanding trade with the capitalists as an expression of Leninism. In *Pravda* in December 1973, Soviet Trade Minister Nikolai Patolichev credited Moscow's "Leninist-principled foreign policy course" for the growth in economic relations between the USSR and the industrial democracies. "The magnetic force of commerce with the Soviet Union with its immense and constantly increasing economic potential," he wrote, compelled the West to seek commercial ties. The industrial democracies were mired in crises, and "had to reckon with the realities that exist in the world today."[64] Engaging the capitalists also seemed to fit Lenin's New Economic Plan in the 1920s. Lenin wanted to milk the West for its technology and

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[62] Todor Zhivkov, "Unanimous and United in the Struggle Against Imperialism," in *Todor Zhivkov: Bulgaria Along the Road to an Advanced Socialist Society*, ed. Zdravko Stankov and Vessa Zheliazkova (Sofia: Sofia Press, 1971), 196-97.

[63] "Zapis' besedy: Ministra vneshney torgovli tov. Patolicheva N.S. s Ministrom ekonomiki FRG g-nom Kh. Friderikhs," March 30, 1976, RGAE, f. 413, op. 31, d. 8237.

[64] Nikolai Patolichev, "Vziamovygodnoe sotrudnichestvo," *Pravda* (Moscow), December 23, 1973, 4. While recognizing that the West had entered a period of crisis, some did not believe that this meant that socialism would erupt around the world. Chernyaev, for example, wrote in his diary: "Marx and Engels were claiming things about capitalism of their day that it hasn't completely reached even now. As for the development of the forces opposing it, it seems the Western interpreters of Marxism are right when they say it is an outdated gospel…After all, it was a brilliant insight and working hypothesis, which was correct even for the sole reason that its development (in theory and practice) had such a powerful impact on the course of history. But I could not write this publicly about the 'Commanifesto.'" Diary of Anatoly S. Chernyaev, December 16, 1972, DNSA

utilize it in the USSR. The capitalists may be "robbers," he said at the Eleventh Party Congress in the spring of 1922, "but they know how to do things."[65]

Others, however, were not so sure. In his memoirs, the Deputy Head of the International Department of the Soviet Central Committee Anatoly Chernyaev recalled a meeting with an unnamed Moscow State University professor who lamented that the Soviets concluded economic agreements with capitalists that lasted decades. "We are tightly binding ourselves to the capitalists, the professor said. "We are helping them to emerge from crises…Hence, we believe that for another 30-50 years there will not be any revolution? Then how are we to teach scientific communism and talk about the death of capitalism?" Chernyaev dismissed the professor's–whom Chernyaev deemed a "moron"–dogmatic adherence to theory, contending that "scientific communism" and "real politics" demanded prudence. "Right now," Chernyaev wrote, "these masses are being handed a real 'perpetual peace' from Brezhnev, and possibly material prosperity in the near future as well."[66]

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The desire for a closer economic relationship with the West could only come to fruition if the industrial democracies reciprocated. Fortunately for CMEA, Western Europe proved a willing partner.[67] Expanding economic relations with the East reinforced the new atmosphere of détente between the superpowers and offered opportunities to extract concessions in exchange for access to Western capital and technology. The British Foreign and Commonwealth Office, for example, believed that by establishing closer economic ties, the West could

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[65] Vladimir Lenin, "Communism and the New Economic Policy," in *The Lenin Anthology*, ed. Robert C. Tucker (New York: Norton, 1975), 520
[66] Diary of Anatoly S. Chernyaev, June 24, 1973, DNSA.
[67] Angela Romano contends that the development of the European Community in the 1970s had a significant East-West component, showing the compatibility of détente and European integration. See Romano, "Untying Cold War Knots: The EEC and Eastern Europe in the Long 1970s," *Cold War History* 14, no. 2 (2014), 153-73.

"unobtrusively…encourage the processes of gradual change in Eastern Europe and the Soviet Union."[68] Closer economic ties reinforced efforts to lower military tensions, resolve outstanding border disputes, introduce provisions on human rights, and promote cultural and human exchanges. One of the most dramatic expressions of the era of détente was West German Chancellor Willy Brandt's *Ostpolitik*, a series of overtures to the Soviet Union, Poland, and East Germany. Brandt and his foreign policy adviser Egon Bahr offered *de facto* recognition of Eastern Europe's borders and access to West German products that would build bridges between Bonn and Eastern capitals. Bonn hoped that closer ties would eliminate the perception that West German posed a threat to the East, a development that would lead to the eventual unification of the two Germanys.[69]

Scholars have ignored, however, the important economic motivations for engaging the socialists.[70] The quality of Eastern European manufactured goods was poor, but Western Europeans viewed access to Soviet oil and natural gas reserves as part of the solution to their own looming energy crisis. Cheap energy from the global South had driven Western Europe's

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[68] Planning Staff paper, "The Longer-Term Prospects for East-West Relations After the Czechoslovak Crisis," November 20, 1968, UKNA, FCO 49/467.

[69] West German foreign policy adviser Egon Bahr quipped that instead of having no relations, at least now the two Germanys had bad ones. On the use of economic incentives to convince Poland to sign the treaty, see Randall Newnham, "Economic Linkage and Willy Brandt's Ostpolitik: The Case of the Warsaw Treaty," *German Politics*, Vol. 16, No. 2 (2207), 247-63. On the intersection of détente and *Ostpolitik*, see Mary E. Sarotte, "The Frailties of Grand Strategies: A Comparison of Détente and Ostpolitik," in *Nixon in the World: American Foreign Relations, 1969-1977*, ed. Fredrik Logevall and Andrew Preston (New York: Oxford University Press, 2008), 146-63. On the link between recognition of borders and détente, see, among others, Wolfgang Mueller, "Recognition in Return for Détente? Brezhnev, the EEC, and the Moscow Treaty with West Germany, 1970–1973," *Journal of Cold War Studies* 13, no. 4 (2011), 79–100.

[70] In analyses of West German Chancellor Willy Brandt's *Ostpolitik*, scholars tend to depict *Osthandel* as a policy of secondary importance compared to Bonn's overarching desire to forge a less confrontational path to the reunification of Germany. *Osthandel* was not just an offering to the East to exact political concessions, however; it also served to help solve Bonn's growing energy problem. Lippert comes closer to the mark by contending that Osthandel was a "prerequisite to *Ostpolitik*," but he also fails to consider the policy's economic benefits for West Germany. He claims, "the FRG had no compelling need for what the Soviet Union was offering," a contention that does not comport with the archival record. See Lippert, *The Economic Diplomacy of Ostpolitik*, 27, 33. Others illuminate the impact of Ostpolitik on West German political relations with the global South, including Sara Lorenzini, "Globalising Ostpolitik," *Cold War History* 9, no. 2 (2009): 223-42.

(and Japan's) prosperity after the Second World War, but by the late 1960s, the political economy of the global oil market had changed.[71] The Libyan Revolution in September 1969 ignited a series of events that transferred power away from multinational oil companies to producer governments. Combined with skyrocketing demand in the industrial democracies, the growing assertiveness of OPEC caused the price of oil to rise steadily in the early 1970s. The Tehran and Tripoli Agreements in early 1971 gave OPEC governments a greater share of profits vis-à-vis international oil companies and increased the urgency of Western Europeans to diversify their sources of energy. In an age of transatlantic discord, imports from the Soviet Union also offered the chance to break the influence of the U.S.- and British-dominated oil companies (known as the "majors").[72] The Italians also saw an agreement with Moscow as a way to "counterbalance against the monopolies" of their Dutch and Libyan suppliers.[73]

The Japanese had similar motivations, and they depended on energy imports from the Middle East even more than the Western Europeans. Siberian raw material development projects and trade became the essential elements of Japan's relations with the Soviet Union. The Japanese offered $1.3 billion in credits to construct portion of pipeline planned to run from Tyumen fields to Nakhodka, to be repaid in petroleum exports.[74] Cooperation with the Western Europeans and Japanese allowed the Soviets to develop their reserves in remote parts of the Soviet Union. In return, Moscow had to divert an increasing proportion of its oil supply to the West to fulfill its

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[71] On the way that decolonization and demands for economic sovereignty drove this change, see Christopher R.W. Dietrich, *Oil Revolution: Anticolonial Elites, Sovereign Rights, and the Economic Culture of Decolonization* (New York: Cambridge University Press, 2017).
[72] "Zapis' besedy Torgpreda SSSR v FRG tov. Vodchkova Ye.P. S kommercheskim direktorom firmy 'Mannesmann-eksport' g-nom Van Beveren, sostoyavsheysya 8 maya 1969 g. V pomeshchenii Torgpredstva, 8 May 1969, RGAE, f. 413, op. 31, d. 1969.
[73] "Zapis' besed Zam. Ministra tov. Osipova N.G. S otvetstvennym upolnomochennym rukovoditelem ital'yanskoy 'SNAM' g. Sakki, sostoyavsheysya 19 aprelya 1967 goda," 19 April 1967, RGAE, f. 413, op. 31, f. 1700.
[74] Department of State briefing paper, "Japanese-Soviet Relations," April 6, 1972, National Archives and Records Administration, College Park, MD, RG 59, Subject Numeric Files, 1970-73, Political & Defense, POL 7 US/Kissinger, Box 2693.

contractual obligations. In 1973, for example, the Soviet Union exported 45 million tons of crude oil and oil products to Western Europe, a figure that represented 38 percent of Soviet oil exports.[75]

The opportunity to gain access to Soviet natural gas reserves was even more attractive. Natural gas had many advantages over coal and oil as a source of energy, with environmental, economic, and scientific benefits. Austria became the first non-socialist country to sign a contract with the Soviet Union for deliveries of natural gas. Natural gas represented a greater proportion of Austrian energy consumption than elsewhere in Europe; unlike other European states, Austria did not have significant coal reserves but it did have natural gas deposits. Consumption rates grew quickly in the 1950s and 1960s as natural gas was popular within industry and private consumers. By the late 1960s, however, domestic production failed to meet demand. The government estimated that the demand in Austria would amount to 2.1 billion cubic meters, but domestic reserves would only yield 900 million cubic meters.[76] The state-owned Österreichische Minerölverwaltung (ÖMV) invested heavily in a network of pipelines that would deliver natural gas around the country, and the company sought to find external suppliers. It considered Dutch and Algerian options, but complications with transporting Dutch and Algerian energy as well as other factors encouraged ÖMV to consider importing from the Soviet Union.[77] In negotiations with the Soviets, Austrian Minister of Trade Otto Mitterer stressed that Vienna placed great importance on expanding trade with the socialists, "regardless of their social and political system."[78] The resulting natural gas agreement with the ÖMV in June 1968 set the

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[75] Klinghoffer, *The Soviet Union and International Oil Politics*, 221.
[76] "Niederschrift über die Sitzung des Arbeitsausschusses des Aufsichtsrates der Österreichischen Mineralölverwaltung A.G. am 27. Februar 1968," February 27, 1968, Österreiches Staatsarchiv (ÖS), Vienna, Austria, Archiv der Republic, ÖIAG-Archiv, Box 135.
[77] Högselius, *Red Gas*, 46-50.
[78] "Zapisi besedy s federal'nym Ministrom torgovli, remyosla i promyshlennosti Avstrii, 28 fevralya 1968 goda v 9 chas 30 min," March 6, 1968, RGAE, f. 413, op. 31, d. 2644.

precedent for future agreements with Western companies, stipulating that ÖMV would provide large pipes, equipment, and expertise in exchange for natural gas deliveries once the pipeline was completed. The delivery price of $14.10 per cubic kilometer compared favorably to market prices.[79]

West Germany quickly followed the Austrian lead. Some have contended that the West Germans only pursued economic relations with the Soviets as a means of extracting political concessions. The historian Werner Lippert recently argued, "Soviet gas was not even of significant commercial interest to the FRG…the FRG had no compelling need for what the Soviet Union was offering."[80] The documentary record does not support this conclusion. Policymakers in Bonn recognized that domestic production would be woefully inadequate to cover rising demand for natural gas in the coming decade. In 1969, the West German Ministry of Economics estimated that domestic consumption would rise from its current level of 6.5 billion cubic meters to between 25 and 26 billion cubic meters by 1975.[81] "The increasing demand of the economy and private consumers for natural gas make the signing of more contracts to import natural gas absolutely necessary," a staffer in the Kanzleramt wrote. In 1971, West Germany supplied 70 percent of its own natural gas demand. By 1974-75, however, the Kanzleramt believed that the proportion would drop to 50 percent and would decrease to 30 percent by 1980. The Netherlands supplied the vast majority of West German imported natural gas and was expected to control about half of the West German market by 1975.[82] Bonn grew wary of the prices that the Dutch companies charged and their increasing influence–a dispute that played out

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[79] A copy of the agreement may be found in RGAE, f. 413, op. 31, d. 2376.
[80] Lippert, *The Economic Diplomacy of Ostpolitik*, 33.
[81] Referat III B 3, "Zahlen zur Erdgasversorgung der Bundesrepublik," May 20, 1969, Bundesarchiv (BAK), Koblenz, Germany, B 102/240343.
[82] Gruppe IV/2 to Abteilungsleiter IV, "Erdgasmarketsituation in der Budnesrepublik Deutschland," January 15, 1973, BAK, B 136/7686.

behind closed doors as well as in the press.[83] With an eye on the growing need to import natural gas, the West German Foreign Office argued that the introduction of Soviet natural gas into the West German market was desirable for “competition reasons.”[84]

The commencement of West German and Soviet negotiations was dramatic. The two sides had engaged in minimal trade after their 1958 trade agreement expired in 1963, and had not been able to strike an extension. West German attempts to resurrect talks failed, particularly in the toxic atmosphere in the aftermath of the Warsaw Pact’s intervention in the Prague Spring in August 1968. Understanding the economic value of Soviet natural gas and recognizing the advantageous political ramifications of expanding economic relations, the West Germans approached Moscow the following year. In March 1969, the West German Minister of Economics Karl Schiller invited Patolichev to the Hannover Messe, which the Soviet minister accepted. At the Hannover Messe the following month, Patolichev expressed the “relatively strong Soviet interest” in working with West German companies to supply the country with more Soviet oil and particularly to collaborate in the field of natural gas.[85] In particular, the West Germans hoped to secure more supply for Bavaria. In the year 1968, Bavarian officials anticipated upcoming natural gas shortages of 500 million cubic meters in 1973, 1 billion cubic meters in 1975, and 2.7 billion cubic meters in 1979.[86] West German policymakers and businessmen from companies such as Ruhrgas A.G. and Mannesmann made these points to

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[83] See, for example, “‘Der NAM geschieht Unrecht’: Deutsche Gasversorgung zu teuer” and “Der Streit um den Erdgaspreis geht weiter,” October 25, 1969, both in *Industriekurier*. Gas prices had actually decreased each year since 1962, but Bonn saw the introduction of Soviet gas as an opportunity to sink prices further. See Referat III B 3, “Verbraucherpreise für Erdgas in der Bundesrepublik,” December 23, 1969, BAK, B 102/152205.
[84] Referat III A 6, “Deutsch-sowjetische Erdgasgespräche,” July 25, 1969, Politisches Archiv des Auswärtigen Amts (PA-AA), Berlin, Germany, B 63, Bd. 435.
[85] Friedrich Schiller to Kurt Kiesinger, April 29, 1969, BAK, B 102/100025. Before issuing a formal invitation, the West Germans floated the idea with Soviet Ambassador Semjon Zarapkin, who relayed a message from Patolichev that the Soviets would respond favorably.
[86] Referat III B 3, “Erdgassituation in Bayern,” May 20, 1969, BAK, B 102/240343.

Soviet negotiators, and tried to use Dutch prices as a reference point–a strategy that irritated The Hague and the Dutch energy companies Nederlandse Gasunie and Nederlandse Aardolie Maatschappij.[87] The West Germans sought to break the Dutch monopoly on natural gas imports, improve the supply of natural gas to Bavaria, and take a step to counter the growing trend in rising energy prices.[88] Although the West German government did not take part officially in the negotiations, Brandt encouraged the West German businesses to sign the agreement.[89]

In February 1970, West German businesses and the Soviet state export agency Soyuzneftexport struck a triangular deal in which Mannesmann supplied the Soviet Union with 1.2 tons of pipes (five feet in diameter) at a cost of $400 million, a consortium of seventeen West German banks gave a $400 million credit to Moscow that would mature after twelve years, and Soyuzneftexport would deliver 5.5 billion cubic meters of natural gas to Ruhrgas A.G. over a twenty-year period that would begin in October 1973.[90] The price for Soviet deliveries was somewhat higher than the cost of purchasing Dutch natural gas, but the cost of transporting Dutch gas to Bavaria made the Soviet deliveries more economical overall. "The meaning for the energy industry," the West German Economic Ministry concluded, "lies in the fact that the FRG

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[87] See, for example, "Zapisi besedy Ministra vneshney torgovli N.S. Patolicheva so stats-sekretarem Ministerstva ekonomiki FRG K Donan'i," 23 maya 1969 g., RGAE, f. 413, op. 31, d. 2985; "Zapis' Besedy Torgpreda SSSR v FRG tov. Volchkova YeP s kommercheskim direktorom firmy 'Mannesman eksport AG' g-nom Van-Bererenom i general'nym direktorom firmy 'Rurgaz AG' g-nom Shel'bergerom, sostoyavsheysya v pomeshchenii Torpredstva v Kyol'ne," 20 maya 1969 g., RGAE, f. 413, op. 31, d. 2985; and Referat III B 3, "Deutsch-sowjetische Verhandlungen über die Lieferung sowjetischen Erdgases am 31.7. und 1.8.1969 in Moskau," August 7, 1969, BAK, B 102/ 240343. The issue became contentious in West German-Dutch relations. See Hans-Otto Schwartz to J.G. de Beus, August 14, 1969; J.G. de Beus to Hans-Otto Schwartz, August 19, 1969; J.G. de Beus to L.G. Wansink, August 19, 1969; all in Nationaal Archief, The Hague, the Netherlands, 2.05.313, 8456.
[88] Abteilung III, "Sowjetische Erdgaslieferungen in die BDR," April 19, 1971, PA-AA, B 63, Bd. 501.
[89] Lippert, *The Economic Diplomacy of Ostpolitik*, 47.
[90] Angela Stent, *From Embargo to Ostpolitik: The Political Economy of West German-Soviet Relations, 1955-1980* (New York: Cambridge University Press, 1981), 167.

is less dependent on Dutch gas and for the first time, Dutch gas has a serious competitor."[91] West Germany and the Soviet Union concluded further deals in 1972 and 1974.

By the early 1970s, Western Europeans had, in the words of scholar Per Högselius, "fallen in love with natural gas."[92] Additional deals included agreements with France, Italy, Japan, and Finland.[93] The Soviets thought carefully about how to streamline their new responsibilities to export natural gas beyond the socialist bloc and sought to supply their customers through an integrated pipeline system, in anticipation of durable business relationships.[94] In March 1976, Patolichev told the West German Finance Minister Hans Friderichs that the Soviets wanted to continue expanding economic relations with the West. "The fact that this is a profitable and promising form of economic relations is evidenced by the fact that it is possible to name off the top of my head about 50 large deals; successfully completed, compensatory transactions, in which 3-4 parties participate, and even several countries. We believe that compensatory deals will occupy an important place in economic relations for the foreseeable future."[95]

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[91] Referat III B 3, "Deutsch-sowjetische Erdgasverhandlungen," January 29, 1970, BAK, B 102/240343. The Soviet gas to Bavaria was delivered to Upper Franconia, located just across the Czechoslovak border.
[92] Stent, *From Embargo to Ostpolitik*, 167.
[93] The most comprehensive examination of the mutual interests of Western Europe and the Soviet Union in signing natural gas agreements is Högselius, *Red Gas*. From a West German perspective, see Lippert, *The Economic Diplomacy of Ostpolitik*. On France, see Alain Beltran and Jean-Pierre Williot, "Gaz de France and Soviet Natural Gas: Balancing Technological Constraints with Political Considerations, 1950s to 1980s," in *Cold War Energy: A Transnational History of Soviet Oil and Gas*, ed. Jeronim Perovic (New York: Palgrave Macmillan, 2017), 231-51.
[94] In the agreement with Austria in June 1968, for example, Article 8 committed the Austrians to allow "unimpeded passage" of natural gas bound for Italy and France in anticipated forthcoming deals. A copy of the agreement may be found in RGAE, f. 413, op. 31, d. 2376. The Soviets transported the natural gas through the relatively new Bratsvo pipeline that linked Eastern Europe to the gas fields of Siberia. The Eastern European states through which the gas pipelines passed such as Czechoslovakia and East Germany received compensation for transportation across their territory. See, for example, "Memorandum peregovorov mezhdu zamestitelem Ministra tov. Osipovym N.G. i Pervym zamestitelem Ministra vneshney torgovli ChSSR tov. F. Marem," October 29, 1975, RGAE, f. 413, op. 31, d. 7477. The Czechoslovaks also negotiated a transportation fee for a proposed deal that would provide West Germany natural gas from Iran, but the agreement collapsed in the wake of the Iranian Revolution.
[95] "Zapis' besedy: Ministra vneshney torgovli tov. Patolicheva N.S. s Ministrom ekonomiki FRG g-nom Kh. Friderikhs," March 30, 1976, RGAE, f. 413, op. 31, d. 8237.

Even the United States entertained the idea of importing energy from the Soviet Union. U.S. oil production reached its peak in the early 1970s, and energy companies looked to the Soviet Union as a prospective supplier. After consulting the State Department, a consortium of two U.S. gas companies (Tenneco and Texas Eastern Transmission) and a U.S. engineering firm (Brown & Root), for example, met with Soviet officials in Moscow in November 1971 to discuss the possibility of concluding a twenty-year agreement to import Soviet natural gas. The LNG (liquefied natural gas) would be transported to the United States by sea in exchange for the U.S. companies' participation in the construction of the pipelines, liquefaction plant, and port facilities. National Security Council staffer Helmut Sonnenfeldt wrote Kissinger that U.S. energy companies, as well as other industries, "are very anxious" to conduct business in the Soviet Union because they believed that "the USSR is essentially a politically stable country," in contrast to alternative sources of natural gas such as Algeria, Libya, and Venezuela. The National Security Council recognized the value of tapping the vast Soviet reserves, but also feared, however, that energy imports from the Soviet Union would give Moscow "some degree of economic weaponry."[96] More than in Western Europe, many worried that Moscow might "close the valves and leave the East Coast to shiver." In June 1973, the consortium signed an agreement with the Soviet Ministry of Trade to launch the "North Star" project, expected to become operational in the late 1970s.[97]

The rapid pace of signing deals with the West initiated a new type of economic relationship between Moscow and the industrial democracies. "A tendency is shaping in our economic relations…to conclude long-term agreements," the Chairman of the Council of

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[96] Helmut Sonnenfeldt, to Henry Kissinger, "Long Term Gas Imports from the USSR?," November 13, 1971, RNPL, NSC Files, Subject Files, Trade Vol. III Dec 1970-Jun 1971, Box 402. "Economic weaponry" was underlined in the original.
[97] Högselius, *Red Gas*, 133.

Ministers Alexei Kosygin wrote in 1971. "This creates a greater foundation for the further development of trade."[98] Chernyaev added that foreign economic relations with the West should not be seen as "a filler for the economy for plugging holes. Instead it is an integral part of planning our national economy, especially for the long-term."[99] Unlike deals for grain, Moscow did not have to pay valuable hard currency and could pay for the loans and equipment by delivering energy. The increase in energy exports provided Moscow with an expanded source of income. While the Soviet Union earned $23 million from natural gas exports to the West in 1972, this figure rose to $184 million in 1975 and $2.84 billion in 1980. The corresponding numbers for oil were $781 million in 1972, $3.977 billion in 1975, and $14.157 billion in 1980.[100] "In our current international economy, there is no such thing as a truly independent nation–not even…the USSR," Austrian economist Franz Nemschak told the Academy of Sciences of the Soviet Union.[101]

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The expanding relationships with the West allowed the Soviet energy industry to develop more quickly than it would have otherwise. It also, however, diverted energy away from the members of CMEA, which badly needed it. Demand in Eastern Europe for Soviet imports

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[98] A.N. Kosygin, *Direktivy XXIV s"ezda KPSS po pyatiletnemu planu razvitiya narodnogo khozyaystva SSSR na 1971-1975 gody* (Moskva: Izdatel'stvo politicheskoy literatury, 1971), 72. The United States proved the outlier among the industrial democracies and its trade with CMEA did not expand as rapidly as its allies'. "Overall our commerce with Eastern Europe probably will always be small potatoes," senior NSC staffer Helmut Sonnenfeldt wrote National Security Adviser Henry A. Kissinger in March 1973. Washington continued to believe that the utility of East-West trade lay in its potential to extract political concessions from the East and saw little economic advantage in expanding commercial relations. See Helmut Sonnenfeldt to Henry Kissinger, "SRG Meeting, NSSM 163: Economic Policies Toward Eastern Europe," March 6, 1973, RNPL, NSC Institutional Files, SRG Meeting–NSSM 163 Economic Policy Toward Europe 3/7/73 [1 of 2], Box H-67. For an overview of U.S. attitudes to trade with Moscow during the Nixon administration, see "Elite Attitudes Toward U.S.-Soviet Trade, 1968-1973," October 16, 1975, Sterling Library Manuscripts and Archives, Yale University, New Haven, CT, Henry A. Kissinger Papers, Part III, Series II. Subject Files, Folder 10, Box 162.

[99] Diary of Chernyaev, April 29, 1973, DNSA.

[100] Smith, *Russia and the World Economy*, 81.

[101] "Vortrag von Prof. Dr. Franz Nemschak, Wien, An der Akademie der Wissenschaften der UdSSR," May 1967, ÖS, Archiv der Republik, BMfaA, II-POL UdSSR 1967.

increased substantially during the 1950s, bolstered by changes in industrialization, energy utilization processes, and relatively low fuel prices.[102] By the 1960s, the Eastern Europeans had generally shifted from a preponderant reliance on coal to a greater mix of imported hydrocarbons from the Soviet Union. With all but a small percentage of the group's reserves, Moscow supplied CMEA's energy needs in exchange for overpriced manufactured goods.[103] In sum, the Soviet Union provided about 85 percent of Eastern Europe's oil requirements. The Soviet Union was also the only country to export significant amounts of natural gas to the members of the socialist bloc, which it supplied through pipelines that ran across Uzhgorod, Drozdovichi, and Izmail.[104]

At a meeting in June 1971, the CMEA Standing Committee of Oil and Natural Gas envisioned energy shortages on the horizon. The Polish delegation, for example, informed the committee that Soviet oil deliveries would fall short of Polish domestic demand by 1 million tons in 1972, 800 thousand tons in 1973, 500 thousand tons in 1974, and 1.5 million tons in 1975. The East German contingent added that their shortages would total about two million tons in 1975. The Hungarians, Czechoslovaks, and Romanians voiced similar concerns, and they agreed that meeting the bloc's energy demand after 1975 represented a serious problem. The only solution at the moment was to seek the balance on the world market, and "the import of oil from third countries has great importance." How to manage this problem "remains open"[105] In 1971, CMEA collectively imported almost 10 million tons from third countries, but the CMEA

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[102] George W. Hoffman, "Energy Dependence and Policy Options in Eastern Europe," in *Soviet Natural Resources in the World Economy*, ed. Robert G. Jensen, Theodore Shabad, and Arthur W. Wright (Chicago, IL: University of Chicago Press, 1983), 661-64.

[103] The Soviet Union was responsible for more than 95 percent of the oil production within CMEA in the mid 1970s. Klinghoffer, *The Soviet Union and International Oil Politics*, 185-86. Romania was the only other country that produced oil in any substantial quantities.

[104] Sovet ekonomicheskoy vzaimopomoshchi, Postoyannaya komissiya po neftyanoy i gazovoy promyshlennosti, "Protokol sorok pervogo zasedaniya," December 1974, RGAE, f. 302, op. 2, d. 1191. Romania exported small amounts of natural gas (up to 200 million cubic meters per year) to Hungary annually.

[105] Sovet Ekonomicheskoy Vziamopomoshchi Postoyanno Komissiya po neftyanoy i gazovoy promyshlennosti Protokol, "Tridtsat' Chetvyortogo Zasedaniya," June 1971, RGAE, f. 302, op. 2, d. 831.

Standing Committee of Oil and Natural Gas expected this number to skyrocket over the course of the 1970s. It estimated that imports would total about 32 million tons in 1975, about 52 million tons in 1980, and 56 million tons in 1985. Of the CMEA members, the Soviet Union itself would be the largest importer of oil.[106]

Bulgarian General Secretary Todor Zhivkov viewed access to affordable energy as an existential issue for his country's economy. In September 1973, he told Brezhnev:

> Our needs are 20 million tons of oil each year. Our competent authorities are even suggesting about 22 million tons. I suggested lowering this number, and we came to 18 million tons. About 3 million tons can be imported from the Arab countries. Even if they are ready and willing to export more oil to our country, we will not have the funds necessary to pay. At the moment we have an agreement to receive about 12.5 million from the USSR. This still leaves about 2.5 million tons which we would like to receive from you.

As a solution to the problem, Zhivkov proposed that the Soviet Union purchase more oil from the Arab producers in quantities that the Bulgarians could not. The Soviets could then sell the oil to the Bulgarians. Zhivkov acknowledged that other Eastern Europeans might protest if the Soviets did this just for the Bulgarians, but they should not because "we are the poorest in raw materials." If the Soviets did not do this favor for the Bulgarians, Sofia would be forced to go on the "capitalist market at all costs, and you know what the prices are there right now." Brezhnev made no commitment, saying only that he would share Zhivkov's request with the Politburo.[107]

The Soviets encouraged the Eastern Europeans to seek the balance of their requirements on the world market. At the 26th meeting of CMEA in summer 1972, for example, Kosygin acknowledged that Soviet exports failed to satisfy demand in the socialist bloc. A longtime critic

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[106] Sovet ekonomicheskoy vzaimopomoshchi, Postoyannaya komissiya po neftyanoy i gazovoy promyshlennosti, "Svodnyy doklad o predlozheniyakh po vozmozhnym usloviyam importa i transportirovki zainteresovannymi stranami-chlenami SEV nefti iz tret'ikh stran, a takzhe po formam sotrudnichestva," December 1972, Tsentralen darzhaven arhiv (TsDA), Sofia, Bulgaria, f. 130, 25C, a.e. 67.
[107] "Beseda na dr. Todor Zhivkov i dr. Leonid Brezhnev v pravitelstvenata preditsentsiya 'Voden,'" September 20, 1973, TsDA, f. 378B, op. 1, a.e. 693.

of economic centralization, Kosygin understood the inefficiencies of Soviet industry. Kosygin estimated that the total demand of CMEA would total 140-150 million tons by 1980, but he expected that the Soviet Union could only supply a maximum of 75 million tons. He envisioned that covering the full demand would require the member states to purchase about 100 million tons from the producers of the global South by 1990, particularly friendly Gulf countries such as Iraq, Syria, and Egypt. Czechoslovak Prime Minister Lubomír Štrougal noted that it would be difficult to export manufactured goods to these countries to offset the cost of oil imports; the Arabs were "traditionally oriented toward Western firms."[108] The Soviets tried to use the impending energy crisis as a tactic to convince the Eastern Europeans to assume a larger proportion of the financial burden to exploit isolated Soviet energy reserves in Siberia.[109]

With their oil production complications and dependency on sales to the West for hard currency, the Soviets also encouraged the Eastern Europeans to conclude agreements with producers in the non-socialist world, particularly in the Middle East and northern Africa. Already in February 1966, the East Germans recognized that it was "necessary to concentrate all efforts to open up further sources of supply of crude oil and natural gas for the GDR outside of the socialist camp."[110] Eastern European countries began to participate in a number of long-term energy development projects in the Middle East as a means of diversifying their energy sources. "It is time to approach Iraq concretely," Baibakov told Schürer in May 1973, "with the aim of

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[108] "Information über die XXVI. Tagung des Rates für Gegenseitige Wirtschaftshilfe," July 13, 1972; and "Notiz über Meinungsaustausch der Delegationsleiter bei Genossen Kossygin am 12.7.1972 in Moskau," July 13, 1972, both in BAB, DE 1/54796. On Romanian negotiations with Iran for oil deliveries, see Roham Alvandi and Eliza Gheorghe, "The Shah's Petro-Diplomacy with Ceausescu: Iran and Romania in the Era of Détente," December 2014, Cold War International History Project Working Paper #74.

[109] "Information über die erste Konsultation zwischen den Planungsorganen der DDR und der UdSSR zu Grundfragen der Koordinierung der Volkswirtschaftspläne für den Zeitraum nach 1975 sowie zur organisatorischen und methodischen Vorbereitung," undated (but the consultation took place in mid June 1972), BAB, DE 1/54796.

[110] Abteilung Grundstoffindustrie, "Stellungnahme zum Beschluß des Präsidiums des Ministerrates zur Konzeption über die Entwicklung der Erdölverarbeitung bis 1970," February 4, 1966, SAMPO, DY 3023, 455.

securing of securing a high proportion of oil exports and suppressing capitalist groups from the market, based on the opportunities and needs of the Iraqi national economy." The socialists expected oil production in Iraq to rise quickly in the 1970s, reaching 200 million tons per year by the end of the decade.[111] Hungary sent $15 million worth of machinery and equipment to Iraq for the development of the North Rumaila field. Czechoslovakia promised to send materials valued at $32 million to construct a refinery at Basra.[112] Bulgaria concluded agreements with Algeria, Syria, and Egypt for 1972 and 1973 to receive 700,000 tons annually. Sofia promised extended credit to Iraq in the amount of $12 million to help develop Iraq's industrial base. Poland did the same with Iraq, providing a $100 million credit to finance its oil imports.[113] During Schürer's trip to Iraq in June 1974, Iraqi officials indicated that they wanted to increase oil deliveries almost two-fold to four million tons annually in exchange for a greater East German contribution to the industrialization of Iraq. Oil production depended on the development of the Iraqi national economy[114]

The Middle Eastern producers, however, became increasingly resistant to trading oil for Eastern European goods as their confidence and power to dictate the terms of the market grew, and began to demand hard currency instead. Furthermore, there were tremendous complications of transporting energy from the Middle East to the landlocked countries of Eastern Europe. Most of the imported oil from Iran, for example, had to be shipped all the way around Africa.[115]

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[111] Gerhard Schürer, "Information über die Beratungen zwischen Genossen Schürer und genossen Baibakow über Grundfragen der Rohstofflieferungen der UdSSR in die DDR im Zeitraum 1976-1980 am 21.5.1973," May 22, 1973, BAB, DE 1/58507.
[112] CIA paper, "Eastern Europe Offers Limited Market for Middle East Oil," February 6, 1970, CREST.
[113] Sovet ekonomicheskoy vzaimopomoshchi, Postoyannaya komissiya po neftyanoy i gazovoy promyshlennosti, "Svodnyy doklad o predlozheniyakh po vozmozhnym usloviyam importa i transportirovki zainteresovannymi stranami-chlenami SEV nefti iz tret'ikh stran, a takzhe po formam sotrudnichestva," December 1972, TsDA, f. 130, 25C, a.e. 67.
[114] Gerhard Schürer, "Bericht über die Reise in die Republik Irak vom 24. -.28.6.1974," June 28, 1974, BAB, DE 1/58701.
[115] Klinghoffer, *The Soviet Union & International Oil Politics*, 187-88.

The Eastern Europeans also turned to the West for relief and concluded agreements with major companies such as British Petroleum, Shell, and ENI. The largest of these deals included a contract between BP and Poland for which Warsaw paid about £25 million for the construction of a refinery in Gdansk and £15 million per year for crude oil (about 3 million tons at 1971 prices). "The Poles now know that Russian oil will not be available in the quantity required," the British ambassador in Warsaw reported to London, and the Poles needed to find alternative suppliers to meet their needs.[116] Having been told by Moscow in 1970 that the Soviets would only be able to supply 60-65 percent of Czechoslovak need, Prague also turned to BP and sought to come to an agreement for the supply of ten million tons over ten years. In conversations with British diplomats in the Oil Department, BP officials shared that they "saw substantial opportunities for Western suppliers in Eastern Europe."[117]

Even the Soviets themselves negotiated deals with the Arabs. In the summer of 1969, for example, Moscow signed an agreement with the state-owned Iraq National Oil Company to develop a national oil industry in opposition to Western oil companies. The Soviet trading organization Mashinoeksport provided oilfield equipment and technical assistance in return for oil and hard currency. Moscow wanted to expand its influence over Iraq, but the agreement allowed Moscow to supply the oil-deficient regions of the Soviet Union in the Far East by tanker, which was cheaper and more efficient than constructing infrastructure. It also freed a corresponding amount of Soviet oil for Moscow to sell to the West.[118]

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[116] Nicholas Henderson (Warsaw) to FCO, "B.P. Interest in Poland," April 9, 1970, UKNA, FCO 67/405.; Klinghoffer, *The Soviet Union & International Oil Politics*, 189.
[117] P.G. Wallis, "BP in Eastern Europe," March 23, 1970, UKNA, FCO 67/405.
[118] CIA paper, "Intelligence Memorandum: Implications of the Recent Iraqi-Soviet Oil Agreements," October 1969, CREST.

The inability of the Soviet energy industry to meet their needs posed significant problems for the Eastern Europeans. For several reasons, the Eastern Europeans preferred to import raw materials from the Soviet Union rather than the non-socialist world. As the political scientist Lee K. Metcalf notes, the inferior quality of Eastern European manufactured goods meant that they had to sell their products at a discount outside of CMEA. In contrast, the Soviet Union purchased the Eastern European products at a higher price than they would yield on the world market in return for raw materials. The Hungarian Minister of Foreign Trade admitted, "the Soviet market is a permanent safety valve for the sale of products which are difficult to sell or can only be sold under unfavorable circumstances."[119] As energy prices rose in the non-socialist world, the socialists viewed Soviet energy deliveries as even more crucial. A Hungarian economist warned, "we would not be able to purchase this quantity of [raw] material in the capitalist countries, because we would be unable to produce annually the needed dollar funds."[120] Rather than spend valuable hard currency to purchase energy on the turbulent world market, the Eastern Europeans wanted the Soviets to increase deliveries at the fixed price of about 14 rubles per ton. And from a logistical standpoint, importing oil from the Middle East to landlocked Eastern European countries proved a major obstacle. The Eastern Europeans also balked at the Soviet insistence that they play a larger role in investing in the Soviet energy industry. The East German State Planning Commission, for example, believed that investment in the Soviet Union "cannot be the only way to secure an increased supply of raw materials." The increase in Soviet deliveries

[119] Quoted in Metcalf, *The Council of Mutual Economic Assistance*, 99.
[120] Quoted in Ibid, 98.

should be offset instead by corresponding deliveries of East German goods such as chemical products as well as Soviet investment in East German industries.[121]

The growing energy requirement of CMEA represented the maturation of Eastern Europe as a region of industrial economies, but it also contributed to a growing crisis. The global energy crisis came at a particularly vulnerable moment for the Eastern Europeans. Across the region, socialists worried about the portentous consequences of their low economic productivity as the fruits of extensive growth receded. The East German regime, for example, began to fear that economic conditions could precipitate protests that had not been seen in the country for more than a decade. As Stephen Kotkin argues, East German policymakers "walked on eggshells" from concern about the potential of a reprisal of the June 1953 uprising in East Berlin.[122] "Since the increase in the price of sugar before [the June 1953 uprising]," Schürer remembered, "the fear of price increases for basic necessities sat so deeply in the bones of policymakers that nobody made a change."[123] People noticed the growing disconnect between state propaganda about the superiority of socialism and what they saw in daily life. When the discrepancy was noticed in school, an East German woman remembered, "the teachers would say with increasingly less credibility, 'Well, this is what we are working towards. It will be sorted out in a few years.'"[124]

In order to raise the standard of living in the country, General Secretary Walter Ulbricht and Secretary of the Economy Günter Mittag in the mid and late 1960s had pursued a seemingly

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[121] "Einige Grundprobleme der Arbeitsteilung und der Entwicklung des gegenseitigen Warenaustausches, die in der ersten Konsultation zur Koordinierung der Pläne im Zeitraum nach 1975 von der DDR-Seite gestellt wurden," undated (prepared for June 1972 CMEA meetings), BAB, DE 1/54796.
[122] Stephen Kotkin, "The Kiss of Debt," in *Shock of the Global: The 1970s in Perspective*, ed. Niall Ferguson et al (Cambridge, MA: Belknap University Press of Harvard University Press, 2010), 83.
[123] Schürer, *Gewagt und Verloren*, 75.
[124] Hester Vaizey, *Born in the GDR: Living in the Shadow of the Wall* (New York: Oxford University Press, 2014), 48

paradoxical policy of "overtaking without catching up" (*überholen ohne einzuholen*), a strategy conceived to surpass the West in several important industries–chemicals, machine building, and electronics–and serve as an engine that would allow the country to outperform the industrial democracies across other sectors in the future. They believed that a "great leap" in high-value exports would increase East German labor productivity to levels that exceeded those in the West and would eventually cause living standards to pull ahead as well. Importantly, this plan depended on the success of industries that followed the Fordist model, which required huge amounts of energy to produce capital goods. Ulbricht believed that if East Germany could import Western technology and combine it with Soviet raw materials and superior socialist labor, the country would surge past the industrial democracies by the late 1970s. East Germany gained international legitimacy as more Western nations recognized it as a sovereign state, and official diplomatic relations provided more opportunities to secure loans from Western banks to finance those imports.

Ulbricht outlined his strategy to the horrified Soviet Deputy Chairman of the Council of Ministers Nikolai Tikhonov in June 1970, telling him, "We get as much debt with the capitalists, up to the limits of the possible, so that we can pull through in some way. A part of the product from the new plants must then be exported back to where we bought the machines and took on debt. In a short time, we must pay for the equipment…We are, therefore, now correcting the lags from the time of open borders."[125] Ulbricht's was a risky strategy, and many influential members of the government such as Council of Ministers chairman Willi Stoph and Schürer worried about the accumulation of debt. The CIA concluded, "Ulbricht's successors must live more frugally."[126]

[125] Kopstein, *The Politics of Economic Decline in Germany, 1945-1989*, 65-66.
[126] "CIA paper, "Intelligence Memorandum: East German Foreign Trade Policy," August 1, 1971, CREST.

Ulbricht's successor Erich Honecker placed less emphasis on overtaking the West and abandoned Ulbricht's hope of unifying the two Germanys under socialism, but he too articulated an ambitious program of economic development and increased consumer and housing subsidies. "The people need cheap bread, a dry flat, and a job," said Honecker, who had worked as a roofer before the Second World War. "If these three things are in order, nothing can happen to socialism."[127] At this point, East German policymakers believed that the integrity of the regime depended on delivering the promises of socialism immediately, not demanding more sacrifices in return for the promised future. As the historian Mary Fulbrook writes, "Utopian ideas of 'jam tomorrow'…gave way to attempts to ensure more bread and butter, and even cake, today."[128] At the Eighth Party Congress in 1971, East Berlin committed itself to constructing a consumer society based on extensive social programs. East Berlin's "big bet" was that the regime could develop high technology, and that the West would want to buy East German products.[129]

The timing of East Berlin's bet, however, could not have been worse. In the late 1960s and early 1970s, instability in the international monetary system and the rising cost of commodities on the world market disrupted economies across the globe. Although Soviet oil deliveries increased in the 1970s, they did not increase quickly enough to keep pace with East German demand. "The fulfillment of oil demand is a fundamental problem in the development of the GDR," Schürer told Baibakov.[130] Schürer noted in early 1973 that the Soviets promised an increase of two million tons of oil in the post-1975 period, but this "was insufficient to cover requirements for petroleum for chemical processing and other industries." He estimated that the

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[127] Stephen Kotkin, *Uncivil Society: 1989 and the Implosion of the Communist Establishment* (New York: Random House, 2009), 48-49.
[128] Mary Fulbrook, *A History of Germany 1918-2008: The Divided Nation*, 3rd Edition (Chichester, West Sussex, UK: Wiley-Blackwell, 2009), 181.
[129] Kotkin, *Uncivil Society*, 49.
[130] "Information über die Beratungen zwischen Genossen Schürer und Genossen Baibakow," March 16, 1966, SAMPO, DY 30/7148.

minimum quantity that the Soviets had to export to East Germany was 20 million tons; "even then, we have to raise four million tons from third countries."[131] Baibakov rejected the East German request that the Soviets increase energy deliveries, claiming that the Soviet oil industry was in a "difficult situation." Across the Soviet Union in places such as Azerbaijan, Tatarstan, and Grozny, oil production either decreased or stagnated. Baibakov acknowledged that East Berlin would have to rely more heavily on imports from the Middle East, particularly Iraq. He proposed that that CMEA approach Iraq jointly with the hope of "securing a high share of oil exports" in return for supplying the needs of the Iraqi economy. He indicated that a delegation of Gosplan, led by Vice Chairman Lalajanz, planned to leave for Baghdad to raise the issue. Another option was increased Eastern European participation in the development of Soviet energy reserves, particularly the enormous natural gas field in Orenburg.[132]

The East Germans ran a manageable hard currency debt with the West of VM 2.2 billion in 1970.[133] Particularly in its relationship with West Germany, the East German balance of payments deteriorated sharply thereafter. From 1972 onwards, East Berlin estimated that interest payments on the debt alone would total VM 300 million annually. "The problem is not just the debt," the East German State Planning Commission added, "but also the fact that we do not have exports that can immediately generate hard currency."[134] In November 1973, the Central Committee department head of planning and finance Günter Ehrensperger calculated that even if East Germany course reverse its trade deficit by 1980, the country would stumble from the weight of the debt it incurred. "Overall," he wrote, "the calculation shows that this variant is not

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[131] "Informationsmaterial: Stand und Probleme der Wirtschaftsbeziehungen mit der UdSSR," undated (prepared for meeting with Nikolai Baibakov that took place in May 1973), BAB, DE 1/58517.
[132] Gerhard Schürer, "Information über die Beratungen zwischen Genossen Schürer und Genossen Baibakow über Grundfragen der Rohstofflieferungen der UdSSR in die DDR im Zeitraum 1976-1980 am 21.5.1973," May 22, 1973, BAB, DE 1/58517.
[133] Kopstein, *The Politics of Economic Decline in Germany, 1945-1989*, 86.
[134] "Beratung der Parteigruppe MR zum VW-Plan 1972," October 11, 1971, BAB, DE 1/54544.

feasible because of the growing debt and impossibility of financing."[135] Werner Krolikowski, the Central Committee's economics secretary, later wrote that he presented Honecker with a paper that same year that estimated the skyrocketing debt to the West by the following decade. Honecker replied, "OK, so what?" Krolikowski stressed that building socialism on the foundation of loans from the West would cause the GDR to become an "exploitative object" of the West and ultimately the country would become insolvent. Honecker stood up, told Krolikowski that setting policy was his prerogative, and brushed aside fears about the growing debt, accusing Krolikowski of inciting panic (*Panikmacher*) for no reason.[136] Krolikowski was subsequently marginalized from decision making. Honecker and Mittag carefully ensured that discussion of the debt did not take place at Politburo meetings.[137]

The East Germans understood that the growing dependence on the West placed them in a precarious position. They constantly discussed the danger of their reliance on imports from the non-socialist world (*NSW-Importabhängigkeit*). In its estimates for 1972, the State Planning Commission determined that as much as one-third of East German industrial production depended on imports from the non-socialist world. For the most important products that the country produced, including the chemical industry, the influence of imports reached even higher levels.[138] The development plan depended on East Berlin's ability to export goods of superior

[135] Günter Ehrensperger, "Probleme und Konsequenzen aus der Arbeit am Volkswirtschaftsplan 1974 auf dem Gebiet der Zahlungsbilanz gegenüber dem nichtsozialistischen Wirtschaftsgebiet bis 1980," November 6, 1973, SAMPO, DY 30/25761.
[136] "Handschriftliche Aufzeichnung von Werner Krolikowski vom 16. Januar 1990," in *Tatort Politbüro: Die Akte Honecker*, ed. Peter Przybylski (Berlin: Rowohlt, 1991), doc. 22, 323-34. Desperate for cash, East Berlin saw an opportunity to grant asylum to political enemies in return for money from the West. Between 1963 and 1990, Western charities, churches, private donors, and humanitarian organizations such as Amnesty International paid DM 3.8 million to free almost 34,000 political prisoners in East Germany. As economic conditions in East Germany deteriorated, authorities in East Berlin looked at these exchanges as a valuable source of hard currency. See Vaizey, *Born in the GDR*, 81.
[137] Kopstein, *The Politics of Economic Decline in Germany, 1945-1989*, 87.
[138] "Zu bestehenden Disproportionen und deren Überwindung für Importabhängigkeit der DDR gegenüber kapitalistischen Ländern," undated (but included in document collection from 1971), SAMPO, DY 30/7148.

quality to the West to repay their debts. As of 1973, however, East Berlin found that its attempts "have so far been inadequate."[139] The decisions of the late 1960s called for large imports of chemical plans between 1969 and 1973 at a cost of VM 1.4 billion. The plants, however, took a long time to bring into production, and East Berlin did not finance them with exports as planned. "On the contrary," East Berlin had to take out additional loans of VM 1.5 billion to fix additional problems with the chemical industry. Exports fell short by VM 1 billion through 1973. Rising prices of capitalist goods and additional steel imports caused by Soviet delivery shortages created additional hardships. Keeping the commitment to principles of the Eighth Party Congress meant that the East Germans imported finished goods at a price of VM 1.2 billion between 1972 and 1974.[140] Developing a solution to the growing dependence on the capitalist world was not easy. "I have an extraordinarily large problem," Schürer admitted.[141]

At a meeting with Soviet leaders in August 1973, Stoph and Schürer explained that East German plans were failing. "Prices demanded by western countries for their export goods are growing much faster than the revenues we generate for our deliveries to these countries," Stoph said.[142] "We would also like to say openly that we cannot live up to Comrade Brezhnev's instruction about limiting our growing dependence and excessive debt to the capitalist countries." At the end of 1973, Stoph estimated that the East German debt to the NSW would total VM 6 billion ($2 billion). To service the debt, East Berlin would have to pay $600-650

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[139] Komitee der Arbeiter-und-Bauern-Inspektion, "Information über die Kontrolle der Durchsetzung des Beschlusses des Ministerrates vom 28.7.1972 zur 'Analyse über die NSW-Importabhängigkeit,'" March 30, 1973, BAB, DC 14/137.

[140] Staatliche Plankommission, "Probleme und Entscheidungsvorschläge zu den staatlichen Aufgaben 1975," April 10, 1974, BAB, DE 1/58701.

[141] Staatliche Plankommission Staatssekretär, "Persönliche Niederschrift über eine Problemberatung beim Vorsitzenden des Ministerrates am 26.3.1973," March 27, 1973, BAB, DE 1/58580.

[142] "Niederschrift über die Verhandlungen zwischen dem Vorsitzenden des Ministerrates der DDR, W. Stoph, und dem Vorsitzenden des Ministerrates der UdSSR, A.N. Kossygin, im Kreml am 20. August 1973," BAB, DE 1/58507.

million annually. When Kosygin asked how much convertible currency East Germany received for its exports, Stoph answered $600 million. "That is really the outer limit," Kosyin replied. Schürer indicated that the East Germans planned to raise exports by 15 percent in both 1974 and 1975, and even with the additional income, the debt would rise to VM 10 billion ($3.5 billion) by the end of 1975. "We pay on time and then take out new loans," Schürer explained. A bit worried, Kosyin inquired about how the East Germans envisioned the end game of this process. "What are you planning for 1980?," he asked. "How much debt will you have? How large will your exports have to be?" Stoph answered pointedly: "That depends on the amount of raw materials that we receive from the Soviet Union and the rest of the socialist countries."[143]

The East German experience was part of a broader trend in Eastern Europe. Emphasis in Eastern Europe transitioned in the early 1970s from socialist integration to a growing reliance on commerce with the West.[144] In Poland, for example, policymakers also worried about their ability to increase their people's standard of living. The memory of the Polish October of 1956 ignited the specter of popular uprising against the regime in Warsaw. Refusing to trade with the West was not an option for Warsaw. "We need to trade with capitalist countries," Polish leader Władysława Gomułka told Kosygin in May 1970.[145] In December 1970, workers at the Lenin Shipyard in Gdańsk launched a strike over a sudden hike in food prices. After Gomułka was ousted, his replacement Edward Gierek followed a similar plan as Honecker: he sought to

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[143] "Niederschrift über die Verhandlungen zwischen dem Vorsitzenden des Minsiterrates der DDR, W. Stoph, und dem Vorsitzenden des Ministerrates der UdSSR, A.N. Kossygin, im Kreml am 20. August 1973," undated, BAB, DE 1/58507.
[144] The East Germans worried that this might "result in a reduced readiness to deliver to the socialist countries and a further shift in favor of NSW's [non-socialist world] share of Romanian foreign trade." Abteilung Internationale Verbindungen paper, "Plenum des ZK der Rumänischen Kommunistischen Partei 27./28. November 1973," January 2, 1974, SAMPO, DY 30/IV B 2/20/19.
[145] "Notatka z rozmowy Władysława Gomułki z Aleksiejem Kosyginem w Warszawie 13 maja 1970 r.," May 13, 1970, in Tajne dokumenty Biura Politycznego: PR –ZSRR 1956-1970, ed. Wstęp Andrzeja Packowskiego (London: Aneks Publishers, 1998), doc. 43, 628.

borrow heavily from the West to increase consumption and reinvigorate the economy. Gierek wanted to accelerate investment to upgrade and stimulate a stagnating economy. The strategy paid dividends in the short run; Poland's GDP increased almost ten percent from 1970 to 1975. In 1971, Poland's debt totaled $700 million; by 1975, however, it reached $6 billion.[146] The policy of taking out extraordinary loans became known as the "Polish disease."[147]

In Budapest, Hungarian policymakers embarked on the "New Model" economic strategy, a set of policies conceived to give greater freedom to private enterprise in the pursuit of higher productivity. The modernization of the energy economy was an important part of this program, and the share of oil and natural gas in total energy consumption rose dramatically from 28 percent in 1965 to just under 40 percent in 1969. The turn away from coal was driven in part by concerns about cost: coal was twice as expensive as oil and three times as expensive as natural gas. Imports of crude oil rose sharply between 1960 and 1968, growing from 1.46 million tons to 3.22 million tons.[148]

Concerns began to arise about the country's exposure to the capitalist world even in Bulgaria, traditionally the Eastern European socialist country most isolated from the global economy. Within CMEA, Bulgaria had the largest debt service relative to exports bound for the non-socialist world, with a ratio of 43 percent in 1971.[149] A Bulgarian State Planning Commission reported in April 1971 that Bulgaria's previous two five-year plans were "characterized by the continuous deterioration of accounts in capitalist currency." While Sofia's

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[146] William I. Hitchcock, *The Struggle for Europe: The Turbulent History of a Divided Continent, 1945 to the Present* (New York: Random House, 2003), 304.
[147] On Poland, see Kazimierz Z. Poznanski, *Poland's Protracted Transition: Institutional Change and Economic Growth 1970-1994* (New York: Cambridge University Press, 2013).
[148] "Hungary Turns to Oil and Gas," *Petroleum Press Service* 36, no. 3 (March 1969), 92-93.
[149] Romania came in second with a ratio of 36 percent. Czechoslovakia, East Germany, Hungary, and Poland all had more manageable positions, with ratios ranging from 20-25 percent. CIA Directorate of Intelligence, "Eastern Europe's Debt to the West: More Growth on the Installment Plan," December 1972, CREST, https://www.cia.gov/library/readingroom/docs/CIA-RDP85T00875R001700040053-8.pdf.

obligations to the capitalist totaled only 100,000 convertible leva in 1960, that number had increased tenfold a decade later. Most of this increase came from machinery imports. “Because exports lagged behind” targets, interest obligations totaled 300,000 convertible leva by 1970. “The difficulties of covering our deficits in the balance of payments in capitalist currency are high. We can cope with these difficulties only if the entire government pull in one direction: pursuing a decisive curtailment of imports from the capitalist countries, increasing exports to these countries, [and] strict control over distribution and most economical use of the raw materials and other products.”[150]

The chairman of the State Planning Commission Sava Dalbokov, the Minister of Finance Dimitar Popov, and the chairman of the Bulgarian National Bank Kiril Zarev sounded the alarm about the growing debts to the capitalists. In a letter to the chairman of the Council of Ministers Stanko Todorov, they warned that that the country risked falling further in debt. Sofia needed to implement “significant structural changes in production.” They outlined several steps that the country needed to take, including restricting the supply of equipment imported from the capitalist countries, limiting purchases in convertible currency for licenses to 35 million convertible leva, “The main task of state-owned enterprises,” the memorandum concluded, “must be to enhance the competitiveness of exports on the international market.”[151] Concerns about Eastern European-made goods to compete in the non-socialist market would serve as the Achilles heel of the bloc for the rest of socialism’s existence.

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[150] Darzhavna planova komisiya to Todor Zhivkov, “Vnosa ot kapitalisticheskite strani,” April 30, 1971, TsDA, f. 130, 23C, a.e. 1.
[151] Sava Dalbokov, Dimitar Popov, and Kiril Zarev to Stanko Todorov, “Sastoyanieto na platezhniya balans na stranata i proekta na valutniya plan za perioda 1972-1975 godina,” undated (spring 1971), TsDA, f. 130, 23C, a.e. 1.

As the socialists began to reengage the global capitalist economy, the Eastern bloc emerged from its relative isolation. "The years since 1970 have witnessed a major departure from the autarkic development model followed by Eastern Europe during most of the post-war period," the Organization of Economic Cooperation and Development concluded. "Faced with growing strains on resources, and in general a fall in the efficiency of their use," the OECD continued, "Eastern countries are increasingly centering the conduct of their external economic relations upon the possibilities offered by Western technology and expertise to introduce qualitative changes in economic performance which have so far not materialized from indigenous sources."[152] The share of CMEA trade with the industrial democracies rose between 1970 and 1974 from a quarter to a third.[153] Much of this trade was financed with credits. While the debts stayed at manageable levels in the early 1970s, the decision to rely on credits to finance imports would have devastating consequences over the course of the decade.

As the Eastern bloc became more dependent on the non-socialist world for capital, technology, and energy, inflationary trends in the global economy began to wreak havoc on the industrial states of the global North–both capitalist and socialist. The socialists took pleasure in the chaos that economic globalization unleashed on the West. While the industrial democracies diagnosed the problem as symptoms of accelerating "economic interdependence," the East Germans believed that the upward pressure on prices stemmed from "the aggravation of the crisis of the imperialist system," whereby the three centers of capitalist power (North America,

[152] Working Party of the Trade Committee, East-West Trade, "Trends and Outlook in East-West Trade," September 9, 1977, OECD Archive, Paris, France, TC/WP(77)13. The notion that CMEA maintained an autarky has become a cockshy for economic historians, a faulty description that collapses easily as a matter of trade statistics. See Sanchez-Sibony, *Red Globalization*. Nevertheless, autarky remains a useful concept to apply to the socialist bloc until the mid 1960s because the term does not require absolute isolation; CMEA was largely self-sufficient and independent of the free world, despite maintaining limited and non-essential trade relationships with states outside of CMEA.

[153] "Information zur Entwicklung des Außenhandels der RWG-Länder mit kapitalistischen Industrieländern im Zeitraum 1971-1974," undated, SAMPO, DY 30/8935.

Western Europe, and Japan) struggled "for domination and access to raw material sources and commodity markets."[154]

The socialists–particularly those in leadership positions responsible for economic planning such as Schürer–also understood that they were not immune from these changes. In 1970, for example, the East German exports received only 60-80 percent of the price that they had gotten only a year or two prior.[155] Their "big bet" on high technology was failing and the debt began to mount. This increasing vulnerability to changes in the global economy became particularly clear during the oil shock of 1973.

[154] "Auswirkungen der Preisentwicklung von Rohstoffen und Materialien auf dem kapitalistischen Weltmarkt auf den Import der DDR," May 31, 1973, SAMPO, DY 30/J IV 2/2J/4717
[155] "Probleme des Perspektivplanes 1971-1975," no date (included in folder with documents from 1970), SAMPO, DY 3023/461.

Chapter 3

"An Energy Pearl Harbor": The West and the Energy Crisis of 1973-74

During the Yom Kippur War of October 1973, the Organization of Petroleum Exporting Countries (OPEC) announced significant cuts to oil production and price increases, and its Arab members imposed an embargo against the United States, Denmark, and the Netherlands. These measures triggered a worldwide energy crisis that had been brewing for years and threatened to destabilize an already precarious global economy still reeling from the collapse of the Bretton Woods monetary system. The crisis had the potential, in the words of British Foreign Secretary Alec Douglas-Home, to "bring down the economies of all or most of the developed countries."[1] U.S. Secretary of State Henry A. Kissinger took it one step further, warning that the energy crisis portended "the moral and political disintegration of the West."[2] The West had faced an existential challenge from Nazi Germany and the Empire of Japan during the Second World War, Kissinger said in November 1974. "We face another such moment today [and] the stakes are as high as they were twenty-five years ago."[3]

This chapter investigates the diplomatic crisis that the oil embargo and production reductions of 1973-74 caused among the industrial states of Western Europe, the United States, and Japan.[4] Perhaps more than any other event of the 1970s, the energy crisis provides a window

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[1] Alec Douglas-Home to Edward Heath, "Copenhagen Summit: Kissinger's Proposal on Energy," December 13, 1973, United Kingdom National Archives (UKNA), Kew, England, PREM 15/2041.
[2] "Memorandum of Conversation–Ford, Kissinger, French President Valery Giscard d'Estaing, Foreign Minister Jean Sauvagnargues (Meeting 1)," December 15, 1974, Gerald R. Ford Presidential Library (GFPL), Ann Arbor, MI, National Security Adviser's files, Memoranda of Conversations, 1973-77, Box 8.
[3] "The Energy Crisis: An Address by U.S. Secretary of State, Henry A. Kissinger," November 15, 1974, UKNA, Foreign and Commonwealth Office (FCO) 96/28.
[4] This chapter draws inspiration from David S. Painter's recent observation that the historiography of the energy crises of the 1970s suffers from a lack of attention to the geopolitical context. See Painter, "From the Nixon Doctrine to the Carter Doctrine: Iran and the Geopolitics of Oil in the 1970s," in *American energy Policy in the 1970s*, ed. by Robert Lifset (Norman, OK: Oklahoma University Press, 2014), 61-62. The theme of U.S.-European relations in perpetual crisis permeates the literature on transatlantic history after 1945. The intensity of the conflicts turned on the personalities of those in power, economic performance, domestic politics, and changes in the international system. The literature on the subject is too vast to summarize, but see Frédéric Bozo, *Two Strategies*

into the unwelcome effects of economic globalization on the industrial democracies.[5] It signaled the rise of a new type of power in the international arena–one based on the control of a vital raw material. Whereas power had traditionally accrued to those states with military and economic might, the emergence of OPEC modified this calculus. The oil-producing governments had seized the "life-blood of the industrially and technologically advanced nations," international relations theorist Hans Morgenthau wrote in August 1974, and it had "become an instrument of political power."[6] The energy crisis represented the rising power of the oil producers in the international system and left policymakers scrambling to react to the end of cheap energy from the global South.[7] Already stumbling from the collapse of the Bretton Woods, the industrial democracies had to decide how to meet this challenge. The dilemma, British Prime Minister Edward Heath later described, was that "we had to ensure our own economic survival without, if possible, alienating any of our friends in the world."[8]

The energy crisis also, however, provided an opportunity for creative policymakers to embrace the fluidity and reshape it to their advantage. In the face of economic dislocation,

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for Europe: De Gaulle, the United States, and the Atlantic Alliance (Lanham, MD: Rowman & Littlefield, 2001); Jeffrey Glen Giauque, *Grand Designs and Visions of Unity: The Atlantic Powers and the Reorganization of Western Europe, 1955-1963* (Chapel Hill, NC: University of North Carolina Press, 2002); Helga Haftendorn, Georges-Henri Soutou, Stephen F. Szabo, and Samuel F. Wells, Jr., eds., *The Strategic Triangle: France, Germany, and the United States in the Shaping of the New Europe* (Baltimore, MD: Johns Hopkins University Press, 2006); Matthias Schulz and Thomas A. Schwartz, eds., *The Strained Alliance: U.S.-European Relations From Nixon to Carter* (New York Cambridge University Press, 2010); and Marc Trachtenberg, *A Constructed Peace: The Making of the European Settlement*, 1945-1963 (Princeton, NJ: Princeton University Press, 1999).

[5] Economic globalization refers to the convergence of national markets and flows of capital and goods across the world, processes that created interdependence between and among members of the international system. Contemporaries referred to this phenomenon as "economic interdependence." This chapter provides further evidence against the claim that the United States purposefully promoted globalization as a means of extending its influence through neo-liberal practices. See David Harvey, *The New Imperialism* (New York: Oxford University Press, 2003).

[6] Hans J. Morgenthau, "The New Diplomacy of Movement," *Encounter* vol. 43, no. 2 (August 1974), 56-57.

[7] Recent works on transatlantic relations in the 1970s largely ignore the episode, including Helga Haftendorn, Georges-Henri Soutou, Stephen F. Szabo, and Samuel F. Wells, Jr. (eds.), *The Strategic Triangle: France, Germany, and the United States in the Shaping of the New Europe* (Baltimore, MD: Johns Hopkins University Press, 2006); Luke A. Nichter, *Richard Nixon and Europe: The Reshaping of the Postwar Atlantic World* (New York: Cambridge University Press, 2015); Matthias Schulz and Thomas A. Schwartz, ed., *The Strained Alliance: U.S.-European Relations From Nixon to Carter* (New York Cambridge University Press, 2010).

[8] Edward Heath, *The Course of My Life: My Autobiography* (London: Hodder & Stoughton, 1998), 501.

diplomatic discord, and social unrest, the oil crisis offered a chance for officials to propose new tactics of international cooperation. Two strategies emerged: an American strategy that stressed consumer solidarity across the industrial democracies, and a French plan that emphasized the need for an autonomous Europe to meet directly with the producer states. Political commentators and historians have long credited the imaginative overseas initiatives of the Nixon administration, particularly with respect to its role in *détente* with the Soviet Union and *rapprochement* with China, but they have tended to do so in regard to the Cold War only.[9] This chapter emphasizes Kissinger's adaptability in the face of accelerating economic globalization.[10] Initially, Kissinger saw the Middle East crisis in terms of American relations with the Soviet Union, but by late fall 1973, he partially pivoted away from his Cold War-centric view of international affairs to a more comprehensive understanding of the dangers to U.S. national security. He understood that the oil crisis threatened the core postwar U.S. objective of constructing an international system based on democratic capitalism. Kissinger used consumer solidarity as a means of redefining the West in terms of economic cooperation. "The trick in the

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[9] Scholars have been fascinated by Kissinger since he took office, and the literature on the controversial statesman is correspondingly large and growing. Most, focusing on the Nixon years, stress the rigidity of Kissinger's Cold War-centric *Weltanschauung*. See, for example, Robert Dallek, *Partners in Power: Nixon and Kissinger* (New York: HarperCollins, 2007); John Lewis Gaddis, *Strategies of Containment: A Critical Appraisal of American National Security Policy during the Cold War*, rev. ed. (New York: Oxford University Press, 2005); Raymond Gartoff, *Détente and Confrontation: American-Soviet Relations from Nixon to Reagan*, rev. ed. (Washington, DC: Brookings Institution, 1994); Jussi Hanhimäki, *The Flawed Architect: Henry Kissinger and American Foreign Policy* (New York: Oxford University Press, 2004): Walter Isaacson, *Kissinger: A Biography* (New York: Simon & Schuster, 1992); and Barbara Zanchetta, *The Transformation of American International Power in the 1970s* (New York: Cambridge University Press, 2013). Many have pointed to the liabilities of this world view, arguing that Kissinger's preoccupation with the Soviet Union caused him to overlook the local effects of his policies on other parts of the world. For a scathing indictment of Kissinger along these lines in the case of the Indo-Pakistani war of 1971, see Gary J. Bass, *The Blood Telegram: Nixon, Kissinger, and a Forgotten Genocide* (New York: Vintage, 2013).
[10] A few scholars have examined Kissinger's engagement with globalization. See Christopher R.W. Dietrich, "Oil Power and Economic Theologies: The United States and the Third World in the Wake of the Energy Crisis," *Diplomatic History* vol. 40, no. 3 (June 2016): 513-15; and Jeremi Suri, "Henry Kissinger and the Geopolitics of Globalization," in *The Shock of the Global: The 1970s in Perspective* (Cambridge, MA: Belknap University Press of Harvard University Press, 2010), 173-88. Daniel J. Sargent's *A Superpower Transformed: The Remaking of American Foreign Relations in the 1970s* (New York: Oxford University Press, 2015) is the most forceful of these new works and promises to shape the discussion on the subject for the foreseeable future.

world now is to use economics to build a world political structure," Kissinger would later tell President Gerald Ford.[11] He believed that consumer solidary provided a vehicle for Washington to reassert leadership role of the industrial democracies.

The French had an alternative approach. Paris also viewed the energy crisis as an opportunity to retake the initiative in world politics after five years of setbacks and reinvigorate French policy with a sense of purpose.[12] President Georges Pompidou and Foreign Minister Michel Jobert sought to distance Europe from the United States and forge an autonomous European energy policy under French leadership. A common energy policy in the European Community would allow the "Nine" to meet directly with the producers to discuss a range of bilateral issues. Pompidou and Jobert believed that the Europeans had a distinct interest in close relations with the Arabs because of their high dependence on imported oil, and this required that the Europeans develop their own response to the energy crisis. The French also believed that close bilateral contacts with the producer states offered Paris the chance to project its influence outside of Europe in a post-colonial context. The conflict between the American and French visions did not represent a minor procedural disagreement, but a choice between confrontation or engagement with the global South at the beginning stage of an economic insurgency against the industrial democracies that would last for the rest of the decade.[13]

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[11] Memorandum of Conversation between Ford and Kissinger, May 24, 1975, GFPL, National Security Adviser Files, Memoranda of Conversations, 1973-1977, Box 12.
[12] See Frédéric Bozo, *Two Strategies for Europe: De Gaulle, the United States, and the Atlantic Alliance* (Lanham, MD: Rowman and Littlefield, 2001).
[13] The literature on European international history during the 1970s tends to emphasize the détente, Ostpolitik, and the Conference on Security and Cooperation in Europe (CSCE). On détente, see Raymond L. Garthoff, *Détente and Confrontation: American-Soviet Relations from Nixon to Reagan*, rev. ed. (Washington, DC: Brookings Institution, 1994); Jussi Hanhimäki, "Ironies and Turing Points: Détente in Perspective," in Odd Arne Westad (ed.), *Reviewing the Cold War: Approaches, Interpretations, Theory* (London: Frank Cass, 2000); and John van Oudenaren, *European Détente: The Soviet Union and the West since 1953* (Chapel Hill, NC: University of North Carolina, 1991). On Ostpolitik, see Mary E. Sarotte, *Dealing with the Devil: East Germany, Détente, and Ostpolitik, 1969-1973* (Chapel Hill, NC: North Carolina Press, 2001); and Angela Stent, *From Embargo to Ostpolitik: The Political Economy of West German-Soviet Relations* (Cambridge: Cambridge University Press, 2003). On the CSCE, see Vojtech Mastny, *Helsinki, Human Rights, and European Security: Analysis and Documentation* (Durham, NC: Duke

This chapter develops two themes. First, U.S. relations with Europe and Japan during the energy crisis represented negotiation rather than dictation–the experience of the energy crisis does not comport with Geir Lundestad's interpretation of the "empire by invitation."[14] Although Kissinger sought to reestablish U.S. leadership in the Western world, the Western Europeans and Japanese did not accept the framework of cooperation that Washington offered. They resisted it and ultimately managed to alter it in a way that served their own interests.

Second, as noted in the previous chapter about the collapse of Bretton Woods, policymaking during the energy crisis should be examined in the context of both human agency and structural changes in the international system. Long-term economic forces such as an increase in consumer demand and the changing political economy of the oil market brought about the energy crisis, but policymakers still had room to maneuver to manage its effects. In particular, the policies of Kissinger and Jobert stand out as examples of officials who sought to redirect structural forces to their advantage. The new wave of pragmatic and transatlantic-

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University Press, 1986) and Michael E. Smith, *Europe's Foreign and Security Policy: The Institutionalization of Cooperation* (New York: Cambridge University Press, 2004).

For an early study of French and German reactions to the oil crisis, see Horst Mendershausen, *Coping with the Oil Crisis: French and German Experiences* (Baltimore, MD: The Johns Hopkins University Press, 1976). Fiona Venn provides an excellent examination of the divergent interests of the EC and the failure to develop a coherent strategy to deal with economic interdependence. She contends, however, that the tensions within the transatlantic community "continued largely unabated," an argument that this chapter challenges. See "International Co-operation versus National Self-Interest: The United States and Europe during the 1973-1974 Oil Crisis," in *The United States and the European Alliance since 1945*, ed. by Kathleen Burk and Melvyn Stokes (Oxford and New York: Berg, 1999), particularly 71-88. For a French perspective that focuses on the intersection between the energy crisis and European integration, see Aurélie Èlisa Gfeller, *Building a European Identity: France, the United States, and the Oil Shock, 1973-1974* (New York: Berghahn Books, 2012). Guliano Garavini places the energy crisis in the larger context of European interaction with the global South in the context of decolonization in *After Empires: European Integration, Decolonization, and the Challenge from the Global South 1957-1986*, tr. by Richard R. Nybakken (New York: Oxford University Press, 2012).

[14] Beginning with his seminal article "Empire by Invitation? The United States and Western Europe, 1945-1952," a central theme of Geir Lundestad's influential work has been that the United States maintained an informal empire in Western Europe after the Second World War in which Washington set the terms of the relationship and the Western Europeans benefitted from falling under the American economic and military umbrella. David Calleo advances a version of this argument in "America, Europe & the Oil Crisis," in *Atlantis Lost: U.S.-European Relations After the Cold War*, ed. by James Chace and Earl C. Ravenal (New York: New York University Press, 1976), 129. Without the benefit of hindsight, Calleo wonders whether the energy crisis would turn out to be a blessing in disguise, one that would allow the transatlantic community to restructure their relations.

oriented statesmen that came to power in the middle of 1974 in the major industrial democracies–including Gerald Ford, Valery Giscard d'Estaing, Helmut Schmidt, and Harold Wilson–allowed them to work through their problems in a way that their more parochial predecessors could not.[15] They did not reverse the effects of the oil crisis, but they did manage to reconcile the division between the U.S. and French proposals in December 1974 by embarking on a path that sought consumer solidarity and a dialogue with the producers simultaneously. This established a cooperative atmosphere that culminated in the inauguration of economic summitry among the industrial democracies the following year.

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After the Second World War, inexpensive oil fueled the spectacular economic growth in the industrial democracies. As the world's largest producer, the United States' energy dominance and influence around the world formed a critical role in establishing American hegemony in the international system. Political and economic arrangements that favored the main operating companies - known as the "Seven Sisters" or the "Majors"–maintained this energy regime overseas and ensured that cheap oil flowed to the industrial democracies. Beginning in the late nineteenth century, the oil companies benefitted from advantageous treaties with producer governments in the Middle East and elsewhere that granted them concessions to locate, extract, ship, refine, and sell oil. The producer governments, eager to capitalize on their oil reserves, urged the oil companies to boost production in the postwar period, creating a glut in the market and keeping prices low. The increasing exports of the rentier states did not lead to proportional growth in profits: the major oil companies still set the price of oil and controlled 90 percent of

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[15] Policymakers note in their memoirs how important interpersonal relationships are between statesmen, but scholars have largely ignored this crucial part of diplomacy See, for example, Kissinger, *Years of Upheaval*, 933-34; and Helmut Schmidt, *Men and Powers: A Political Retrospective* (New York: Random House, 1989), 164-80.

the production in the Middle East.[16] Realizing that managing production would serve a collective interest by increasing price, five oil producers formed the Organization of Petroleum Exporting Countries (OPEC) in September 1960 to promote cooperation.[17] With divergent interests, however, OPEC could not present a united front, and the relative strength of the companies provided the industrial democracies with an important buffer against concerted action of OPEC.[18]

The Six-Day War represented the best example of the system's resilience against concerted action.[19] After the outbreak of the Israeli-Arab war in June 1967, the Suez Canal, Trans-Arabian Pipeline, and pipelines transporting Iraqi oil to the Mediterranean closed almost immediately. Most Arab nations suspended oil cargo shipments bound for Britain, the United States, and West Germany for their perceived interference in the war on Israel's behalf. In total, the measures affected about 40 percent of Western Europe's oil supplies. The oil companies, however, proved remarkably resourceful and managed to reroute oil supplies from alternative sources to the impacted countries. They overcame the crisis quickly, and by November the oil stocks were larger than they had been before the war.[20]

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[16] Garavini, *After Empires*, 166.

[17] The five included Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela. With the exception of Iraq, they tended to be pro-Western.

[18] For a general discussion of the importance of oil (and other natural resources) in world politics, see David S. Painter, "Oil, Resources, and the Cold War, 1945-1962," in *The Cambridge History of the Cold War: Volume 1, Origins* (New York: Cambridge University Press, 2009), 486-507. Painter's work *Oil and the American Century: The Political Economy of U.S. Foreign Oil Policy, 1941-1954* (Baltimore, MD and London: Johns Hopkins University Press, 1986) remains the standard work on U.S. energy overseas policy in the early Cold War. For a short but comprehensive overview of the structure of the postwar oil trade, see Horst Mendershausen, *Coping With the Oil Crisis: French and German Experiences* (Baltimore and London: Johns Hopkins Press, 1976), 3-17.

[19] The consuming countries had to contend with two other interruptions in the normal flow of oil from the Middle East in the postwar period. The first came in 1951 when the Iranian crude was eliminated from the market, but the oil companies easily offset it by increasing production elsewhere. The second case came during the Suez Crisis of 1956-57 when the Suez Canal closed and IPC pipelines shut down. The companies offset this in a similar way. On OECD strategies for handling oil interruptions before and during the October 1973 crisis, see Oil Section, "Report on O.E.C.D.-Wide Apportionment of Oil Supplies in an Emergency," November 19, 1973, Organization of Economic Cooperation and Development (OECD) Archive, Paris, France, DIE/E/PE/73.126.

[20] Royal Dutch Shell Briefing Service, "The Oil Companies and the Crisis," December 1967, UKNA, POWE 63/245. For a discussion of the embargo and its effects on U.S. foreign policy, see Christopher R.W. Dietrich,

Two structural factors changed this regime. First, the demand for oil in the industrial democracies skyrocketed in the decades after the Second World War. Oil increasingly displaced coal as the energy of choice in the industrial democracies.[21] World energy consumption more than tripled between 1949 and 1972, and oil demand increased more than five and a half times. During the same period, U.S. consumption rose from 5.8 to 16.4 million barrels per day (bpd). Even this paled in comparison to the rates of consumption in Europe and Japan. From 1949 to 1972, consumption rose in Europe from 970,000 to 14.1 million bpd and in Japan from 32,000 to 4.4 million bpd.[22] Rising demand favored the producers in the Middle East in the long-term, who possessed about 60 percent of the proven reserves in the world.

Second, by the late 1960s the American oil fields could no longer keep pace with demand, even when working at full capacity. By 1970, domestic production peaked at 11.6 million barrels per day (bpd), but consumption soared to 14.6 million bpd.[23] In March 1971, when the Texas Railroad Commission ordered an all-out production at 100 percent of capacity, the chairman reflected, "Texas oil fields have been like a reliable old warrior that could rise to the task when needed. That old warrior can't rise anymore."[24] Saudi Arabia replaced the United States as the world's swing producer, supplying oil in cases of shortage. The U.S. government turned to the possibility of constructing an Alaskan pipeline to flow oil to the lower 48 states, but the project posed significant problems. Echoing the challenges facing the Soviets in Siberia, U.S. geologists had never worked in such unforgiving terrain and harsh weather, and the endeavor

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"'More a Gun at Our Heads Than Theirs': The 1967 Arab Oil Embargo, Third World Raw Material Sovereignty, and American Diplomacy," in *Beyond the Cold War: Lyndon Johnson and the New Global Challenges of the 1960s*, ed. by Frances J. Gavin and Mark A. Lawrence (New York: Oxford University Press, 2014).

[21] In Western Europe, for example, coal constituted about 75 percent of the energy consumption in the late 1940s. The proportion dropped to 23 percent by 1972.

[22] Daniel Yergin, *The Prize: The Epic Quest for Oil, Money, and Power* (New York: Free Press, 1991), 523.

[23] Robert Lifset, "Introduction," in *American Energy Policy in the 1970s*, 4.

[24] Yergin, *The Prize*, 549.

required a new generation of technology. The delay meant that Alaskan oil from the North Slope reserves could not make an immediate impact on the U.S. market.[25] The country reluctantly turned to oil imports to fill the gaps.[26]

These changes in supply and demand, however, would not have been enough to precipitate an energy crisis; the political structure of the oil trade kept power and prices in the hands of the oil companies. Between 1969-1971, a watershed occurred in the oil market that empowered the producer governments at the expense of those companies.[27] In particular, the

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[25] George A. Lincoln to Walter J. Hickel, "National Security Aspects of Oil Pipeline from Alaska," November 11, 1971, Richard M. Nixon Presidential Library (RNPL), Yorba Linda, CA, NSC Files, Subject Files, Oil 1971, Box 367. The weather and geographical challenges of extracting oil from Alaska mirrored those that the Soviets faced in Siberia. This topic will be addressed in Chapter 5. For a general discussion of the extraction of oil from Alaska, see John Strohmeyer, *Extreme Conditions: Big Oil and the Transformation of Alaska* (New York: Simon & Schuster, 1993).

[26] The Nixon administration addressed the energy issue shortly after entering office in 1969. Eisenhower had instituted oil import quotas in 1959, allowing for imports to equal 12.2 percent of domestic production in most parts of the country (with the exception of the states west of the Rocky Mountains where it equaled the difference between estimated demand and estimated supply from U.S. and Canadian sources). In the late 1950s, oil imports were thought to threaten national security because of their low cost. Cheap oil from the Eastern Hemisphere would cause high-cost domestic wells to shut down, leaving the United States dependent on imports that could compromise foreign policy and leave the country vulnerable in the event of a war. The quota system also protected the domestic oil industry from foreign competition. The quota system had loopholes, however, and by 1971, imports represented a quarter of domestic consumption. Domestic production simply could not meet the steep rise in demand. The cost of crude, though, stayed constant in the United States until February 1969, when the major producers, led by Texaco, raised the price by five percent. In March 1969 Nixon commissioned a cabinet-level task force to study the problem. The main issue was how to protect U.S. domestic oil companies and production without overburdening the consumers, who were already paying prices 65 percent above the world market. The majority, including chairman George Shultz, William Rogers, Melvyn Laird, and David Kennedy recommended regulated imports by setting tariffs conceived to yield the desired volume of imports instead of quotas. They would privilege imports from the Western Hemisphere against oil from the Eastern, which policymakers believed to be unreliable. The advantage would be increased competition, saving consumers about $5 billion each year and fighting inflation. The interests of domestic producers proved more important to Nixon, however, and the president rejected the task force's recommendation to replace the import quota system with a tariff. See Bergsten to Kissinger, "Oil Import Policy – Report of the Cabinet Task Force," January 9, 1970, RNPL, NSC Files, Subject Files, Oil 1970 [Dec 69-1970], Box 367; and Sargent, *A Superpower Transformed,* 136-37. The report described Canadian and Mexican oil as "nearly as secure politically and militarily as our own" and envisioned that imports from those two countries would be exempt from the program. See Cabinet Task Force on Oil Import Control, *The Oil Import Question: A Report on the Relationship of Oil Imports to the National Security* (Washington, DC: U.S. Government Printing Office, 1970). Secretary of the Interior Wally Hickel and Secretary of Commerce Maurice Stans preferred the existing quota system (with modifications) and wrote dissentions. The quota system put a large burden on consumers because the domestic price of crude oil was about 65 percent higher ($3.30) than if there had been no import controls ($2.00), adding an additional $5 billion cost to consumers. It was naturally popular in the oil-producing states such as Texas and Louisiana, but was deeply unpopular in most other regions of the country, particularly the east coast and Hawaii.

[27] For an excellent examination of the long-term struggle for economic sovereignty with special attention to oil, see Christopher R.W. Dietrich, *Oil Revolution: Anticolonial Elites, Sovereign Rights, and the Economic Culture of Decolonization* (New York: Cambridge University Press, 2017).

Libyan revolution in September 1969 marked the crucial turning point. The new government under Muammar Qaddafi, who viewed himself as Nasser's ideological successor, pursued a foreign policy based on anti-imperialism, sovereignty of national resources, and Arab unity. The Libyan Arab Republic confronted the oil companies, and in January 1970 Qaddafi summoned the heads of twenty-one oil companies to renegotiate the terms of the revenue-sharing agreements. He told them that he would rather cut oil production completely than continue to allow Westerners to exploit Libya. "People who have lived without oil for 5,000 years can live without it again for a few years in order to attain their legitimate rights," Qaddafi informed them. Although the companies resisted the initial demand of a 20 percent increase in the price of oil, Libya supplied about a quarter of Europe's oil and the companies could not afford a serious disruption. Occidental Petroleum and the Oasis Group signed a landmark deal in September 1970, agreeing to an increase in the price of oil of 30 cents and establishing a new industry standard of a 55 percent tax rate.[28] Posted prices of short-haul Iraqi, Iranian, and Saudi Arabian oil delivered by pipeline to the Eastern Mediterranean increased soon thereafter.

The rest of the producer governments also sought better arrangements with the companies. The Tehran agreement–concluded in February 1971 by the six Persian Gulf members of OPEC and representatives of the thirteen oil companies–stipulated an increase of 35 cents in the posted price of crude and a 55 percent tax rate, leading to an estimated $12 billion in additional profit during the five years of the agreement.[29] The terms of the Tehran agreement

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[28] Eugene Rogan, *The Arabs: A History* (New York: Basic Books, 2009), 359-61. All oil prices were quoted in US dollars. The problem for Europe in particular was compounded by the fact that Suez Canal and Trans-Arabian pipeline closed in June 1967, and many had turned to "short haul" suppliers such as Libya to avoid the high transportation costs of importing oil from the Gulf. This was initially not a problem because the Europeans could trust the pro-Western authoritarian Libyan government under King Idris to keep the pump flowing. Thus, the Qaddafi takeover caught the Europeans in a vulnerable position.

[29] The six Persian Gulf members of OPEC were Abu Dhabi, Iran, Iraq, Kuwait, Qatar, and Saudi Arabia. The companies included BP, CFP, Gulf, Mobil, Shell, Socal, Esso, Texaco, Continental, Sohio, Hispanoil, Aminoil, and

weakened the oil companies' position in subsequent negotiations over Mediterranean oil with the Libyans, who could "hardly be expected to be more gentle." The Tripoli agreement, reached in April 1971, established the conditions for Algerian, Iraqi, and Saudi crude piped into the Eastern Mediterranean, raising the posted price of crude by almost 90 cents. In total, the two agreements raised aggregate oil revenue of the Libyan and Middle Eastern governments by about 50% in 1971 ($1.3 billion) compared to 1970 ($2 billion). The agreements calmed tensions between the producers and oil companies and avoided a coordinated interruption of supply to the industrial world, but early 1971 marked further gains for the producer governments against the companies.[30] An article in *Foreign Affairs* captured the changing landscape of the oil market: "The Oil Crisis: This Time the Wolf is Here."[31]

As a result, policy toward the Arab-Israeli conflict occupied a central role in Western European relations with the producers. Eager to curry favor with the producer governments, the Western Europeans backed away from their earlier support of Israel.[32] The European position in the Arab-Israeli conflict thus took an increasingly important role in their relations with the oil producers. Prior to the 1967 war, most of the Europeans strongly sided with Tel Aviv and supplied the Israelis with arms and funds. As their oil dependency rose, however, their attitudes changed correspondingly. The West German Foreign Office concluded in April 1973, "the

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Signal. C. Fred Bergsten to Kissinger, "World Oil Situation," March 9, 1971, RNPL, NSC Files, Subject Files, Oil 1971, Box 367.

[30] "NSSM 114 – World Oil Crisis," May 5, 1971, RNPL, NSC Institutional Files, Study Memorandums (1969-1974), NSSM 114 [1 of 2], Box H-180. For a short summary of events from 1969-1971, see Esso Europe, "Historical Background to Oil Negotiations in Libya," no date, National Archives and Records Administration (NARA), College Park, MD, RG 59, Subject Numerical Files 1970-73, PET Libya 6, 3/3/71, Box 1507.

[31] James Akins, "The Oil Crisis: This Time the Wolf Is Here," *Foreign Affairs*, vol. 51, no. 3 (April 1973), 462-90. The Director of the Office of Fuels and Energy at the State Department, Akins had been recruited to help with Nixon's energy message, but his emphasis on conservation lost him favor with the president's advisers White House. Nixon appointed Akins ambassador to Saudi Arabia to get rid of him. See Jacobs, *Panic at the Pump: The Energy Crisis and the Transformation of American Politics in the 1970s* (New York: Hill & Wang, 2016), 42-43.

[32] The Netherlands represented a possible exception. The Hague interpreted Resolution 242 in such a way that left open the possibility of "border correction" and maintained that Israel had the right to secure borders. In the United Nations, the Netherlands voted against resolutions that called for self-determination for Palestine.

objective interests of the West lie with the Arabs, not the Israelis. The Arabs have oil and purchasing power for consumer goods."[33] The rest of the Europeans shared this sentiment, and this policy occasionally paid dividends. Since the end of the 1967 war, for example, the French adopted the strongest pro-Arab position.[34] In the aftermath of the Algerian nationalizations and uncertainty over Libyan intentions, French purchases of oil from the Middle East grew and the French prioritized developing good relations with the producers of the Gulf. When Iraq–a country whose oil reserves were estimated to be second only to that of Saudi Arabia–nationalized the Iraqi Petroleum Company, it offered the French company Compagnie Française des Pétroles a privileged position.[35]

Despite the growing recognition of their vulnerability in the energy sphere, on the eve of the October War the industrial democracies had no coherent plan for how to rectify it. In the few years after the Libyan revolution, the consumers made little progress in developing a solution. "Our problem on oil is that we do not have a strategy," Kissinger admitted to Jobert.[36] The European Commission submitted a memorandum to the European Council of Ministers arguing that the Community should adopt a number of policies, including a supply program that would

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[33] Französische Botschaft in der Syrischen Arabischen Republik: Schutzmachtvertretung für die Interessen der Bundesrepublik Deutschland, "Das Ärgernis des Friedens," February 21, 1973, Politisches Archiv des Auswärtigen Amts (PA-AA), Berlin, Germany, B 36, Bd. 104943 (ZA).
[34] It also gave Paris a chance to project French influence in the Middle East through its post-colonial foreign policy.
[35] Colin T. Crowe, "Oil and Anglo/Arab Relations," October 2, 1973, UKNA, FCO 93/297. The French signed a new agreement with IPC in early February 1973 that guaranteed the years delivery of 12-13 million tons of oil from the northern Iraqi oilfields near Kirkuk for a period of ten years. See Deutsche Botschaft-Paris to AA, "Französische Energiepolitik," PA-AA, B 71, Bd. 113913 (ZA). For a survey of French-Iraqi bilateral relations, see David Styan, *France and Iraq: Oil, Arms and French Policy Making in the Middle East* (New York: I.B. Tauris, 2006). The nationalization of IPC, the most important of several Western-owned companies in Iraq, was caused by the decrease in IPC's production, which resulted in a decline in the government's income. The British, too, took tried to placate the Arabs, particularly because of their turbulent history in the Middle East. After the United States, the British considered themselves the next logical target of an oil disruption. The Arabs had bitter memories of the Balfour Declaration and the mandate system after the First World War, and (correctly) suspected British collusion with Israel during the Suez Crisis. In addition, British capital investment in Middle Eastern oil through BP and Shell made the UK a target of economic nationalism. Colin Crowe, "Oil and Anglo/Arab Relations," October 2, 1973, UKNA, FCO 93/297.
[36] "The Secretary's Conversation with French Foreign Minister Jobert," October 11, 1973, NARA, RG 59, Subject Numeric Files, 1970-73, Political & Defense, POL 7 FR 4-30-73, Box 2272.

diversify sources of imports, and a stockpiling of 65 days of petroleum as a buffer in the event of an emergency. The Commission believed that the "energy problem is no longer resolvable on a national basis, but only through cooperation of all members of the Community."[37] The Commission also sought to collaborate with others outside the Community, but the French blocked such overtures.[38] The OECD had established a protocol in November 1972 to apportion oil based on consumption, but the sharing scheme only applied to Europe. Furthermore, the plan assumed that the United States could provide assistance by diverting its own imports to others in need and draw upon its spare producing capacity, an ability that the U.S. no longer had.[39]

On the European side, the issue turned on whether to pursue a Community path or one that included the United States and Japan. The French advocated that the Community develop its own strategy independent of the United States. Alain Brion, Assistant Director of the Department of Energy within the French Ministry of Industry, told his American counterpart that French elites believed that if Europe negotiated with oil producers as individual countries, "they would be eaten up by the American wolf." Most of the major oil companies were American, and the U.S. alone had influence in the Middle East. With the exception of the West Germans, the Community had a weak economic position and could not afford to compete with the United States if it came to a bidding war. The British, in contrast, believed that some form of

[37] Gruppe IV/2 (BMWF), "Energiepolitik der Europäischen Gemeinschaft: Neue Initiative der Kommission," October 25, 1972, Archiv der sozialen Demokratie der Friedrich-Ebert Stiftung, Bonn, Germany, Willy Brandt Archiv, A8/50.
[38] Fiona Venn, "International Co-operation versus National Self-Interest: The United States and Europe during the 1973-1974 Oil Crisis," 76-77.
[39] Oil Section, "Report on O.E.C.D.-Wide Apportionment of Oil Supplies in an Emergency," November 19, 1973, OECD Archive, DIE/E/PE/73.126. The OECD established an informal working group on June 13, 1973 to develop a sharing scheme that would include the non-European members of the organization, but the energy crisis erupted in October, before the group finished its report in November. The report called for the European allocation scheme to remain intact, but it created four additional "blocs" for apportionment of oil, including North America, Japan, Australia/New Zealand, and "rest of the world." Stocks accumulated before an emergency were to be excluded from apportionment.

cooperation among the major industrial democracies (the United States, Europe, and Japan) was necessary to protect consumers from the effects of blackmail by producers. Cooperation would pressure the producers to enact reasonable policies and "to prevent 'mavericks' among the consumer countries and oil companies from breaking out of line." Less suspicious of U.S. intentions and more dependent on Washington than the French, London hoped to convince Washington to put forward a proposal for consumer cooperation among the industrial democracies.[40]

Washington's support of Israel cast a shadow over European policymaking. The Europeans worried that a call for cooperation with the United States would lead the Arabs to retaliate with discriminatory measures. In September 1972, British Permanent Under-Secretary of State of the FCO Denis Greenhill noted that the major consumers had neither a viable policy on protective collaboration with each other nor the identification of a community of interest with the producers. The reason, Greenhill said, was the divergent interests of the consumers, which made effective defensive collaboration in the short term impossible. "The objective was right but it would be a long haul." Furthermore, "the consumer country which took it upon itself to blow the trumpet for consumer co-operation," Greenhill concluded, "would do intense harm to its national interests and would fail to secure its objective because the other consumers would not line up behind it [out of fear for their own national interests]. There was no magic wand." Consumer cooperation could get nowhere without the United States, but "the U.S. was in this context a political liability" because of its close relationship to Israel.[41]

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[40] Minutes of a Meeting held in Room 78, Treasury Chambers: Oil Policy," January 24, 1973, UKNA, FCO 8/1964. The emerging energy relationship between the West and the Eastern bloc in the late 1960s and early 1970s will be explored in chapter 5.

[41] "Record of a Meeting in Sir Denis Greenhill's Office," September 5, 1972, UKNA, FCO 93/297. Others, however, believed that the initiative should come from somebody other than the United States because an American overture could be interpreted as an attempt to reestablish hegemony.

On the eve of the Yom Kippur War, the industrial democracies found themselves in a precarious position. Well aware of the structural changes in the international economy, they considered possible courses of action but could not decide on a coherent policy. The domestic and international conversations about how to handle the predicament foreshadowed the debates that would take place across the industrial democracies when the crisis finally arrived in October 1973.

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In the early afternoon of October 6, 1973–Yom Kippur in the Jewish calendar - Egypt and Syria launched a coordinated surprise assault against Israel along the east bank of the Suez Canal and in the Golan Heights.[42] After Arab advances in the first few days in the war, the Israelis counterattacked and began to assert themselves on both fronts. On October 10, the Soviets initiated an airlift to Syria via Hungary and Yugoslavia that would later be extended to Egypt and Iraq. Fearing that Israel could not win a war of attrition against enemies with a larger pool of manpower reinforced by Soviet supplies, the Nixon administration began a resupply of Israel two days later, known as Operation Nickel Grass. The October War brought the superpowers close to confrontation in its final days, but also brought them into daily communication through the Kissinger-Dobrynin channel in Washington. On October 22, the United States and Soviet Union jointly proposed a ceasefire in the UN that called for all parties to cease military activities and implement Resolution 242.[43] The Security Council approved

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[42] All Israeli and American analysts before October 1973 considered an Arab assault on Israel highly unlikely because the Arabs lacked the military capability to defeat the Israelis on the battlefield. Sadat's tactic, however, was to provoke an international crisis that would reopen negotiations. If the Arabs could make some territorial gains and shatter the Israeli aura of invincibility and Arab feeling of impotence before the international community intervened, they would be in a much stronger negotiating position than they were under the status quo after the 1967 War. For an explanation of why the attack caught the United States off-guard, see Kissinger, *Years of Upheaval*, 459-67

[43] Adopted in November 1967, UN Security Council Resolution 242 required the withdrawal of Israeli forces from territories occupied during the war. The English and French versions contained a minor grammatical difference that became politicized. In the English version, the resolution omits a definite article, while the French version contains a

Resolution 338, but fighting continued.[44] The Israelis continued to make progress against the Arabs, and when a new ceasefire finally took hold on October 25, the Israeli army had pushed the attackers back to the 1967 lines and even further at some points.[45]

The international effects of the Yom Kippur War reverberated far beyond the Arab-Israeli conflict and superpower relations: the war precipitated economic and political crises in the industrial world. Much of the divergence among the industrial democracies stemmed from a disagreement about what was really at stake in the war. More than any other event of the 1970s, the war highlighted the growing fissures among the industrial democracies and the extent to which the United States and its allies believed that the Cold War was at stake in the Middle East.

Kissinger tended to view world events through the lens of the Cold War and relations with the Soviet Union. As historian Barbara Zanchetta argues, "the American attitude throughout the war was heavily influenced by the constant view of the conflict through the prism of U.S.-Soviet relations."[46] Kissinger believed that the Middle East represented a "testing ground" for superpower relations.[47] He wanted to avoid a crisis that would hurt relations with Moscow or allow the Soviets to expand their influence. After State staffer Joe Sisco informed him early in the morning of October 6 about the imminent outbreak of hostilities between Israel and the Arabs, Kissinger first phoned Soviet ambassador Anatoli Dobrynin. Kissinger stressed to the Soviet ambassador the importance of restraining the Syrians and Egyptians because "it is very

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definite article. The significance lies in the fact that the French version resolves the ambiguity of the English version about which territories were addressed in the resolution.

[44] Brought jointly by Moscow and Washington, UN Security Council Resolution 338 called for a ceasefire within 12 hours and the immediate implementation of Resolution 242.

[45] On superpower relations during the war, see Garthoff, *Détente and Confrontation*, 360-408; and Craig Daigle, *The Limits of Détente: The United States, the Soviet Union, and the Arab Israeli Conflict, 1969-1973* (New Haven, CT: Yale University Press, 2012).

[46] Barbara Zanchetta, *The Transformation of American International Power in the 1970s* (New York: Cambridge University, 2014), 125.

[47] Jussi Hanhimäki, *The Flawed Architect*, 305.

important for our relationship that we do not have an explosion in the Middle East right now."[48] If the Soviets backed the Arabs and adopted an anti-American position, "they can kiss MFN and the other things goodby [sic]."[49] Although Kissinger leaned toward Israel, he sought to create a diplomatic solution that would leave neither side with a preponderant position. If Israel won a resounding victory, Kissinger reasoned, then the Arabs would direct their anger toward the United States and move closer to the Soviet Union. At the same time, he could not allow the Arabs (whom he perceived to be Soviet clients) to defeat an American ally.

The rest of the industrial democracies, however, took a different approach. The latest crisis in the Middle East, British ambassador Rowley Cromer reported back to London, "accentuated the difference between the American and the European view of the Middle East. The Americans tend to see the Middle East problem as one primarily of East/West relations." In contrast, "the European view is that relations with the Russians are not automatically at stake in the Middle East." European dependence on Middle Eastern oil required that Europe develop its policies toward the Arab-Israeli dispute with an eye on how they would affect access to energy. In the absence of Cold War stakes, Cromer argued, "it is right that we should act to safeguard our own interests."[50] The European economy could survive only about 60 days in the event of an oil embargo, and this vulnerability encouraged the Europeans to downplay the Cold War stakes in play during the war.[51]

Instead, fear that the Arabs would deploy the oil weapon shaped the Europeans' policy toward the October War from the very beginning. Most declared neutrality and sought to work

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[48] Transcript of Telephone Conversation Between Secretary of State Kissinger and the Soviet Ambassador (Dobrynin)," October 6, 1973, *FRUS,1969-1976, vol. 25, Arab-Israeli Crisis and War, 1973*, doc. 100.
[49] "Minutes of Washington Special Actions Group Meeting," October 6, 1973, *FRUS, 1969-1976, Volume XXV,* doc. 112.
[50] Rowley Cromer to Thomas Brimelow, November 22, 1973, UKNA, FCO 82/288.
[51] Willis C. Armstrong to Kissinger, October 13, 1973, "European Vulnerability to Arab Oil Embargo," RNPL, NSC Institutional Files, Washington Special Action Group, Box H-93.

towards a settlement based on Resolution 242. The longer that the war continued, British Minister of State for Foreign and Commonwealth Affairs Robert Lindsay stressed, the more it would damage British economic interests. The conflict might expand to include Arab nations such as Lebanon or Jordan that did not participate in the initial attack on Israel, and more importantly, a protracted conflict could induce the Arabs to use the oil weapon to apply pressure on the West.[52] The British took "care not to identify [themselves] in any way with the Israeli war effort, or with apparently pro-Israeli American policies or action and to express as much sympathy as possible with the Arab side in our public statements."[53]

The French adopted the most pro-Arab position among the Europeans. British Ambassador Edward Tomkins defined the French position as "determined to emerge from this crisis without damage to their 'privileged' relations with the Arabs, and having reinforced these if they can." Paris depicted Egyptian and Syrian motivations as simply trying to reclaim territory that already belonged to them under international law–French Foreign Minister Michel Jobert rhetorically asked: "Does trying to return to one's own territory constitute an unexpected aggression?"[54] Tomkins reported to London that Jobert's policy "stinks of petrol."[55]

Simultaneous to the war, OPEC countries met with oil companies in Vienna to negotiate an increase in the posted price of oil. Iran was the most aggressive proponent of the increases, and it was largely disengaged from the Arab-Israeli conflict. The companies offered an increase of 15 percent, an offer that the producers deemed "grossly inadequate"; the producers demanded

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[52] "Record of a Meeting Between the Minister of State for Foreign and Commonwealth Affairs and a Delegation of MPs at the Foreign and Commonwealth Office on Monday 8 October 1973 at 3pm," UKNA, FCO 93/256.
[53] A.D. Parsons, "Our Objectives in the Present Middle East Crisis," October 11, 1973, UKNA, PREM 15/1765. The British faced domestic opposition to their stance, particularly from the Jewish community, who could not understand why the Heath government did not condemn Arab aggression and provide aid to Israel. See, for example, "Record of Conversation Between the Foreign and Commonwealth Secretary and a Delegation of the Board of Deputies of British Jews at the Foreign and Commonwealth Office," October 15, 1973, UKNA, FCO 93/264.
[54] Edward Tomkins to FCO, "Arab/Israel: The French Attitude," October 10, 1973, UKNA, FCO 93/257.
[55] Tomkins to FCO, "Arab/Israel: The French Position," October 18, 1973, UKNA, FCO 93/265.

an increase of 100 percent.[56]After consulting Western governments, the companies refused to improve their offer. The meeting adjourned without an agreement, but delegates from Saudi Arabia, Iran, Iraq, Abu Dhabi, Kuwait, and Qatar reconvened in Kuwait City to discuss a unilateral price increase and a "war oil policy."[57] On October 16, they announced an increase of the price of oil by 70 percent, bringing it to $5.11 a barrel. This action marked the final stage in the transition of the oil market from one in which the companies set the price to one in which the exporters unilaterally set the price. The collapse of Bretton Woods also contributed to OPEC's desire to raise the posted price; with about 80 percent of oil transactions carried out in U.S. dollars, the devaluations of the dollar in the early 1970s put upward pressure on oil prices. OPEC wanted to reclaim their lost profits.[58] Soon thereafter, the Arab members of OPEC announced an embargo against the United States, the Netherlands, and Denmark for their support of Israel, and stated that each petro-state would cut production by five percent per month from the September level until Israeli forces withdrew from the occupied territories of 1967.[59]

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[56] Douglas-Home to various embassies, "Oil Negotiations in Vienna," October 11, 1973, *Documents on British Policy Overseas, The Year of Europe: America, Europe and the Energy Crisis 1972-1974, Series III, v. 4.*, edited by Rohan Butler and M.E. Pelly (New York: Routledge, 2006), doc 266.

[57] Memorandum From William B. Quandt of the National Security Council Staff to the President's Deputy Assistant for National Security Affairs (Scowcroft)," October 10, 1973, *FRUS, 1969-1976, vol. 36, Energy Crisis, 1969-1974*, doc. 210.

[58] Daniel J. Sargent, "The Cold War and the International Political Economy in the 1970s," *Cold War History*, vol. 13, no. 3 (April 2013), 403.

[59] Yergin, *The Prize*, 583-94. On October 19, Nixon publicly announced a $2.2 billion aid package for Israel; Libya announced an embargo against all shipments to the U.S. that very day. The next day, Saudi Arabia and the others followed suit. The British government concluded that a cut back of 5 percent in the supply of Arab oil equaled a reduction of 3.5 percent of total supply. See "Conclusions of a Meeting of the Cabinet," 18 October 1973, UKNA, CAB 128/53/9. The Arab embargo on the United States amounted to about 2 million barrels per day, a sum that equaled about 11 percent of total U.S. oil consumption. Ben Huberman to Kissinger, "Current Oil Situation," October 23, 1973, RNPL, NSC Institutional Files, WSAG Meeting-Middle East-10/24/72 [2 of 2], H-92. Dutch popular opinion, with the exception of the extreme left-wing, strongly sided with Israel. This attitude stemmed from guilt of the fate of Dutch Jews during the Second World War as well as a belief among protestant sects that saw Israel as the fulfilment of biblical prophecy. The Algerian ambassador in London told Greenhill that the Algerians had taken the lead on proposing the embargo on the Netherlands because the Dutch refused to meet a group of Arab ambassadors to discuss the crisis. The Algerians "were furious and took the line that if the Dutch treated the Arabs as being of no account the Arabs would damn well show them that they were wrong." Duco Hellema, Cees Wiebes, and Toby Witte contend that the Arabs imposed the embargo for more than the Dutch support of Israel. By striking at Rotterdam, the oil gateway to Europe, all of northwest Europe would be affected. The embargo was thus a

The Netherlands was a target of the embargo for two reasons. First, the Arabs accused the Dutch government of adopting a pro-Israel position in the war. In particular, they claimed that the Netherlands had encouraged volunteers to fight for the Israelis. The Dutch government responded that the Dutch people were not allowed to enter into military service in foreign countries without permission, and The Hague had not given permission to anybody.[60] In retaliation for transporting mercenaries and volunteers to fight for Israel, the Arabs also announced a boycott of Royal Dutch Airlines KLM, the Belgian Airline Sabina, and Pan American.[61]

Second, the Netherlands was singled out because of the country's prominent role in the international oil trade. The country was home to Dutch Shell, one of the largest multinational oil companies. Much of the oil to Western Europe travelled through the port of Rotterdam for processing and distribution; by embargoing the Netherlands, the Arabs managed to disrupt the entire network of oil distribution in north-west Europe.[62]

The announcement caught the West by surprise. As described above, policymakers had recognized the dangers of their oil dependence, but they doubted that OPEC would use oil as a political weapon at this point. U.S. Assistant Secretary of the Interior Stephen A. Wakefield

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measure to put pressure on the whole EC. It also served to divide the EC on the proper reponse, thereby making any unified EC political intervention more unlikely. See John Barnes to FCO, "Middle East," October 12, 1973, UKNA, FCO 93/264; Denis Greenhill, "Middle East: Oil and the Netherlands," November 2, 1973, UKNA, 8/1967; and Duco Hellema, Cees Wiebes, and Toby Witte, *The Netherlands and the Oil Crisis: Business as Usual* (Amsterdam: Amsterdam University Press, 2004), 71. As a result of the Dutch policy–or at least because of how the Arabs treated the Netherlands–the Dutch government received an outpour of support from individuals and groups abroad who supported Israel. For a sample of this correspondence, see the materials in Nationaal Archief (NNA), The Hague, 2.05.313, 14531.

[60] Ministerraad, "Notulen van de vergadering gehouden op vrijdag 12 oktober 1973 in het Catshuis, aangevangen 's morgens om 11 uur en 's middags voortgezet," October 12, 1973, NNA, 2.02.05.02, 1237.

[61] W.J.J.D. thoe Schwartzenberg aan BZ, "K.L.M. – Baghdad," October 22, 1973, NNA, 2.05.313, 14524; and "3 Airline Companies Boycotted," October 24, 1973, *Baghdad Observer*. The Dutch government immediately reacted by stressing publicly that the embargo stemmed from "misunderstandings" about the Dutch position on the Arab-Israeli conflict. It stated its strong support for a solution on the basis of Resolution 242. "Regeringsverklaring inzake het Nederlandse standpunt t.a.v. het Midden-Oosten conflikt," October 23, 1973, NNA, 2.05.313, 14525.p

[62] Hellema, Wiebes, and Witte, *The Netherlands and the Oil Crisis*, 10.

described the announcement as an "energy Pearl Harbor."[63] Previously, many officials doubted that OPEC could overcome their divergent economic and geopolitical interests to deploy the oil weapon. The CIA had pointed to the unsuccessful attempt in 1967 as evidence of OPEC's inability to present a common front and believed the reasons behind its failure "remain compelling."[64] The Dutch Foreign Minister reported a week into the war that On October 16, the very day of the oil price hike, the West German Cabinet minutes reported that German "oil supply for the near future is secure. The invitation of Kuwait to a conference to consider the utilization of oil as a weapon against the West did not resonate."[65]

The industrial democracies scrambled to react. OPEC may have only targeted a few countries with an embargo, but the reduction in production affected all consumers. The OECD had emergency oil-sharing protocol for Europe, but London and Paris blocked its activation out of fear of what kind of message it would send to the Arabs.[66] In particular, they feared the domestic ramifications that an interruption in oil supply would precipitate. The British government, for example, worried that if a serious crisis arose and government "failed to match the pressure of events," the public would hold the Conservative Party responsible, potentially putting the future of the Heath government at risk.[67] At the beginning of November, the Nine issued a joint communique that they believed would satisfy the Arabs. They called for the application of Resolutions 242 and 338. The Community also stressed "the need for Israel to end the territorial occupation which it has maintained since the conflict of 1967." This explicit

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[63] Stephen A. Wakefield, "The Fuel Crisis: An Energy Pearl Harbor," *Public Utilities Fortnightly*, December 6, 1973, 23-33.
[64] "Memorandum prepared in the CIA" Aug 28, 1969, *FRUS, vol. 36,* doc. 8.
[65] Referat 310, "Aussenpolitische Unterrichtung des Bundeskabinetts am 17. Oktober 1973," October 16, 1973, PA-AA, B 1, Bd. 576.
[66] Gfeller, *Building a European Identity*, 118.
[67] "Conclusions of a Meeting of the Cabinet," October 16, 1973, UKNA, CAB 128/53/8.

reference to the territories that Israel occupied after the 1967 war clashed with their earlier vague support of Resolution 242.[68]

Operation Nickel Grass illustrated the strains within the Atlantic community. As part of its resupply effort, the U.S. transported material to Israel from its domestic bases, but the planes needed to refuel at airfields in Europe. Among America's European allies, however, only Portugal allowed U.S. planes to refuel on its soil (at the U.S. Air Force base in the Azores Islands); the others directly or indirectly dissociated themselves from the operation and banned overflight from their territories. They feared how their participation would look to the Arabs. U.S. planes from West Germany had to fly over the Atlantic to avoid French and Spanish airspace, enter the Mediterranean at Gibraltar, and fly on to Israel, totaling a detour of almost 2,000 miles.[69] The Europeans argued that the operation illegally involved NATO to defend a territory not covered by the treaty. The "enraged" French characterized the U.S. request as constituting an "arrogant assumption that it was U.S. role to decide the right course of action and allies' role to follow orders."[70] Kissinger fumed at what he considered insubordination and called the alliance into question. "When I look at the European behavior in this crisis," he said to his staff, "I ask myself what in God's name is this alliance. They assert the indivisibility of our

[68] A copy of the declaration on November 6 can be found in NNA, 2.205.313.
[69] Kissinger, *Years of Upheaval*, 709.
[70] John Irwin to State Department, "French Views on Consultation," November 1, 1973, RNPL, NSC Files, Country Files Europe – France, Vol. XI, April-December 31, 1973, Box 679.

interest in defense and in every other respect conduct themselves as neutrals."[71] More crudely, he claimed, "the Europeans behaved like jackals. Their behavior was a total disgrace."[72]

The conflict between Washington and Bonn echoed the deeper crisis between the U.S. and Europe. Like its European neighbors and Japan, West Germany depended on the Gulf to cover the lion's share of its oil supply–about 71 percent of its imported oil come from the Arab states (including Libya and Algeria). Not wanting to alienate its Arab suppliers, Bonn sought to make it clear to the Arabs that it took its declaration of neutrality seriously and would not aid Israel.[73] The West Germans did not fear a serious balance of payments problem because of the recent revaluation of their currency, but they had an especially vulnerable position because they did not have a large oil company that could divert supplies to West Germany in the event of an emergency. West Germany also received most of its oil from the Netherlands (particularly Rotterdam), which had already been placed under an embargo, and was thus already indirectly affected by the crisis.[74] Although the conservatives criticized the Social Democrats for failing to support Israel, fears of an oil embargo superseded sensitivities about Germany's Nazi past and relations with Washington.[75]

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[71] "Secretary's Staff Meeting, October 25, 1973," NARA, RG 59, Transcripts of Secretary of State Henry Kissinger's Staff Meetings, 1973-77, Box 1. At this meeting, Kissinger requested that his staff prepare a paper that considered the future of U.S. relations with Europe. The paper concluded that the alliance "continues to provide the best vehicle available for pursuing our interests in common with the Allies. It is far from perfect, but can be improved by adaptation." Adaption to the new economic realities would become Kissinger's goal beginning in late 1973 (discussed below). *FRUS, 1969-1976, Volume E-15, Part 2, Documents on Western Europe, 1973-1976*, doc. 38.

[72] "Secretary's Staff Meeting, October 25, 1973," NARA, RG 59, Transcripts of Secretary of State Henry Kissinger's Staff Meetings, 1973-77, Box 1.

[73] Referat 403 an Referat 310, "Beitrag zum Informationserlaß Abteilung 3 zum Nahostkrise," October 19, 1973, PA-AA, B 36, Bd. 104948 (ZA).

[74] Referat 403, "Sitzung des Bundeskabinetts am 28.11.1973: Besuch des algerischen Energie und Industrie-Ministers Abddessalam und des Saudi-arabischen Energieministers Yamani am 3.12.1973 in Bonn," PA-AA, B 71, Bd. 113906 (ZA). The Arab governments had severed diplomatic ties with the FRG after Bonn's decision to supply Israel with arms in 1965, and Bonn did not want to repeat this experience.

[75] Jeffrey Herf, *Undeclared Wars with Israel: East Germany and the West German Far Left, 1967-1989* (New York: Cambridge University Press, 2016), 229-30. For a broader history of German-Israeli relations in the postwar period, see David Witzhum, "Unique Dilemmas of German-Israeli Relations: A Political Avoidance of Tragedy," in

On October 16, U.S. ambassador Martin J. Hillenbrand informed FRG Foreign Minister Walter Scheel about the American resupply effort, arguing that the Soviet airlift to the Arabs had forced Washington's hand, and that U.S. material from West Germany would participate in the mission. Scheel expressed concern about how this would affect West German relations with the Arabs, but sympathized with the need to reestablish a military balance in the Middle East. He did not raise any objection to the American plan.[76] If U.S. used their own ships, the West Germans could at least have some measure of plausible deniability that they knew where the American ships were heading.

In conversations with the West Germans throughout the conflict, the Arabs threatened that they would extend the embargo to countries that did not maintain acceptable positions. The Egyptians, for example, summoned the West German ambassador in Cairo twice on October 21 to voice their "deepest concerns about the continued American resupply [of Israel] from German soil. Ashraf Ghorbal, an adviser to President Anwar Sadat, complained that Israelis deployed the supplies against Egypt on the Sinai Peninsula and warned about a possible oil embargo against the FRG.[77]

Bonn took that warning seriously. After the ceasefire, State Secretary in the West German Foreign Office Paul Frank demanded that the weapons deliveries from the FRG cease immediately.[78] The West Germans passed a copy of Frank's conversation with Hillenbrand to

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Germany and the Middle East: Patterns and Prospects, ed. by Shahram Chubin (New York: St. Martin's Press, 1992).

[76] "Gespräch des Bundesministers Scheel mit dem amerikanischen Botschafter Hillenbrand," October 16, 1973, *Akten zur Auswärtigen Politik der Bundesrepublik Deutschland (AAPD) 1973, Bd. III* (München: R. Oldenbourg Verlag, 2004), doc. 322.

[77] Walter Jesser, "Entwicklung des Verhältnis zwischen der Bundesrepublik Deutschland und der arabischen Welt seit dem Ausbruch des Nahost-Krieges am 6.10.1973," October 23, 1973, PA-AA, B 36, Bd. 104949 (ZA).

[78] In his diary, Hillenbrand voiced his annoyance that Kissinger had not kept him up to date about the nature of the U.S.-Soviet ceasefire agreement. On October 23, he wrote "Do we have a cease-fire in the Near East or do we not?...Since as usual we are all informal about what Henry and the Soviets agreed in Moscow as for arms deliveries in the Near East, I could do little more than agree to report the German Government's position to Washington. With

Cairo to demonstrate to the Egyptians that Bonn would not allow any further shipments to Israel from its territory. Soon thereafter, however, an article in a West German newspaper reported that Israeli ships were docked at Bremerhaven and being loaded with tanks and munitions, and a journalist phoned Frank to ask what the government had to say about it.[79] This infuriated the Arabs, who charged that the West Germans had no credibility. It also infuriated the West Germans, who were embarrassed by the situation and had assumed that the U.S. would honor Bonn's request. "Nobody will believe us anymore," Frank told Scheel.[80] The controversy stemmed from the 100 trucks and 75,000 rounds of 105mm ammunition that the Israelis planned to load at Bremerhaven. Unknown to the West Germans, an additional 10,000 rounds were due to arrive on October 27 by plane from Ramstein Air Base.[81] The West Germans protested to the Americans, particularly objecting to the fact that *Israeli* ships carried cargo (although Bonn also denied Washington the right to use American ships). The emergency situation had ended, Frank said, and so too did the need to involve West Germany in the operation.[82] Bonn had shown understanding for American interests thus far, and now Washington needed to respect West German needs.

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his craze for secrecy, Henry can at times disable American diplomacy. He does not, unfortunately, have the slightest care that friends and allies resent being treated with mistrust." Hillenbrand diary entry for October 23, 1973, Richard B. Russell Library for Political Research and Studies (RBRL), University of Georgia Libraries, Athens, Georgia, Martin J. Hillenbrand Papers, Folder 21: June 16, 1973 – December 9, 1973, Box II.2

[79] AAPD, doc 335. The West Germans publicly called on the United States to cease the resupply effort. See "Keine Bundeswehr-Waffen in den Nahen Osten," 22. Oktober 1973, *Frankfurter Allgemeine Zeitung*, p. 3.

[80] Paul Frank, *Entschlüsselte Botschaft: Ein Diplomat Macht Inventur* (Stuttgart: Deutsche Verlags-Anstalt, 1981), 267.

[81] "Telegram 15456 From the Embassy in the Federal Republic of Germany to the Department of State," October 25, 1973, *FRUS, 1969-1976, Vol. E-15, Part 2*, doc. 272.

[82] "Gespräch des Staatssekretärs Frank mit dem amerikanischen Gesandten Cash," October 24, 1973, *AAPD*, 1973, Bd. 3, doc. 335. The Foreign Office isolated the Department of Defense during the crisis. FRG Defense Minister Georg Leber called Hillenbrand on October 24 to tell the U.S. ambassador that he assumed the Foreign Office had not consulted him about its resupply policy because it was aware of Leber's strong pro-Israel sentiments. See Hillenbrand to Washington, "FRG Concerns Regarding US Weapons Shipments From FRG to Middle East," October 24, 1973, NARA, AAD, https://aad.archives.gov/aad/createpdf?rid=117686&dt=2472&dl=1345.

Believing that the resupply effort *was* in the West German interest, U.S. officials fumed at this "outrage" of West German behavior. Hillenbrand met Frank for a showdown on October 25 to get Bonn back in line.[83] The American ambassador claimed that West German action weakened the unity of the West in the face of continued Soviet military support to the Arabs. The United States had no other choice but to aid Israel, he said, and the breakdown of the ceasefire required additional action. Frank stonewalled Hillenbrand, however, arguing that the integrity of West German policy with the Arabs was at stake.[84] After the meeting, Hillenbrand reported to Washington that the atmosphere was "very nasty" and he "got absolutely nowhere" with Frank.[85] That day, West Germany publicly called on Washington to halt deliveries to Israel from West Germany.

In the aftermath of the war, high-ranking officials in the Nixon administration–including Kissinger, Secretary of Defense James R. Schlesinger, and the president himself–publicly admonished the Europeans for failing to cooperate over the resupply of Israel, failing to support the U.S. decision to declare a full military alert on October 26, declining to endorse American proposals at the NATO Council, and refusing to support U.S. initiatives with the Soviet Union to achieve a ceasefire. In November, Kissinger angrily described his view of the state of U.S.-

[83] Kissinger called West German policy an "outrage" at his October 25 staff meeting. The Israelis, too, strongly objected to the German position. An Israeli student group penned a protest letter to Brandt, writing the "new Germany continues in the wicked ways of her Nazi predecessor. The Nazis butchered six million of our brothers in the name of an evil ideology, [and] the new Germany has taken oil as its excuse to succor those who would complete the Nazis' final solution." See Jesco von Puttkamer (Tel Aviv) an AA, "Reaktion auf Bremerhaven," October 29, 1974, PA-AA, B 36, Bd. 104950 (ZA).
[84] Frank said that since Scheel's meeting with Hillenbrand on October 16, none of the West Germans "conceived it possible that Israeli ships would be used to transport the arms and military goods from Bremerhaven." The Arabs had initiated an embargo against the Netherlands for little reason, and an embargo against the FRG would lead to "a chaotic situation." The United States had no legal right under the NATO treaty or the troop agreement of 1954 to deliver its materials from German soil to a warzone outside of NATO. "Gespräch des Staatssekretärs Frank mit dem amerkisansichen Botschafter Hillenbrand," October 25, 1973, *AAPD*, 1973, Bd. 3, doc. 338.
[85] "Secretary's Staff Meeting, October 25, 1973," NARA, RG 59, Transcripts of Secretary of State Henry Kissinger's Staff Meetings, 1973-77, Box 1.

European relations to Cromer. The French now set the tone for European thinking on transatlantic relations, and "the alliance had no firm base anymore," he complained.[86]

Not for the first time, Kissinger over-reacted to an emerging schism in the Western relationship. His rigid adherence to a worldview that only saw events in terms of their impact on the Soviet relationship and blinded him to the predicament of America's European and Japanese allies. He castigated them for failing to follow Washington's policy of supporting Israel, but he failed to offer a constructive alternative to the Community and Japan that would meet their reasonable concerns about ensuring the continued flow of oil. From his post at the U.S. embassy in Bonn, even Hillenbrand fumed at Kissinger's behavior, characterizing U.S. policy as "Stupid! Stupid! Stupid!...What does seem incredibly stupid to me is the way we treat our European friends." In addition to criticizing Bonn for refusing to participate fully in the resupply effort, "Washington in its castigation of our Allies had seemed to overlook their great dependency on Arab oil, as there has been a notable absence of helpful ideas from Washington about what the industrialized countries of Europe and Japan could do to prevent the kind of seriousness and social chaos which the suspension of Arab oil sources would cause."[87]

American angry reactions to European behavior may have been a result, in the words of the Robert Lindsay, of the "exasperation[s] of men operating under great internal and external strains," but strains in the transatlantic relationship "could not be entirely dismissed as…ephemeral."[88] Kissinger's behavior during the crisis aggravated tensions, but the deeper cause of the mutual exasperation stemmed from uncertainty about a very real and substantive

[86] Cromer to FCO, "Meeting with Kissinger: US-European Relations," November 24, 1973, FCO 82/288.
[87] Martin Hillenbrand diary entries for October 25 and 28, 1973, RBRL, Martin J. Hillenbrand Papers, Folder 21: June 16, 1973 – December 9, 1973, Box II.2
[88] Minutes of the 50th Meeting of the Permanent Under-Secretary's Planning Committee," November 20, 1973, UKNA, FCO 49/491.

dilemma facing the industrial democracies: How should they adapt to an international order that no longer offered access to cheap energy in the global South?

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The West had to contend with two major interconnected problems: the economic effects of the energy crisis and the political disunity of the industrial democracies. The West now lived, according to Kissinger, "in a never-never land…in which tiny, poor and weak nations can hold up for ransom some of the industrialized world."[89] To compound the problem, it was unclear how far the situation would further deteriorate. In early November, OAPEC decided to reduce production by 25 percent from the September level. On December 22-23, OPEC raised the posted price from $5.12 to $11.65, representing almost a 400 percent increase in comparison to prewar prices. Analysts across the industrial democracies projected that OPEC's collective surplus would reach about $60 billion in 1974.[90]

Each of the industrial democracies attempted to take domestic measures to counter the effects of the oil crisis, including posting lower speed limits, regulations on energy consumption in government buildings, and increased research into domestic sources of energy. New domestic policies alone could not solve the energy crisis (at least not in the short term); it required an international response. The United States utilized its geopolitical leverage to deal with several members of OPEC to break the cartel. Washington maintained pressure on the Arabs throughout the crisis, appealing particularly to allies Saudi Arabia and Iran, but the Americans believed that these efforts needed to be supplemented with a cooperative response in the international

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[89] "Secretary's Staff Meeting, January 7, 1974," NARA, RG 59, Transcripts of Secretary of State Henry Kissinger's Staff Meetings, 1973-77, Box 2.

[90] After hearing that Qadhafi planned to visit Paris in November 1973, Pompidou quipped to Heath, "If [Qadhafi] were so misguided as to stay at a hotel, he might find that there had been a sudden 400 percent increase in hotel prices." "Record of Points Arising in Conversations During the Return Journey of Monsieur Georges Pompidou, President of the French Republic, From Chequers to London Airport on Saturday 17 November 1973," November 19, 1973, UKNA, FCO 33/2122.

community. The United States needed to facilitate a coordinated policy with the Europeans and Japanese.

In a time of crisis, Kissinger saw an opportunity. Director of the Policy Planning Staff Winston Lord wrote Kissinger that one of the "silver linings of the oil embargo" was the chance "to revitalize our alliances by moving toward cooperation across the energy front."[91] By late fall 1973, Kissinger came to view the energy crisis as a chance to reconstruct the West around consumer solidarity. In the absence of high tensions between the capitalist and socialist blocs, the alliance could be reoriented away from containment of communism toward the challenges posed by economic interdependence. Kissinger sought to use the maintenance of the oil crisis as a means of redefining the West. A coordinated response, Kissinger believed, offered the West a way to solve the economic and political crises that had been mounting for several years and that the energy crisis had triggered.

Kissinger's move toward consumer cooperation in late 1973 marked a new phase of development in Washington's education about the nature of the new economic system of the 1970s. While the Treasury–particularly under George P. Shultz after June 1972–developed a strategy to embrace financial globalization during the collapse of Bretton Woods, the end of 1973 marked the point at which the Department of State also engaged these changes. The overarching U.S. overseas objective remained the construction of an international system based on the principles of democratic capitalism. Previously, policymakers in Washington had seen the Soviet Union as the chief threat to a free-flowing democratic capitalist international order, but now Kissinger identified economic globalization as an additional threat to American grand strategy. Both communism and OPEC posed threats to the central U.S. goal of an international

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[91] "Memorandum From the Director of the Policy Planning Staff (Lord) to Secretary of State Kissinger," December 1, 1973, *FRUS, 1969-1976, vol. 36,* doc. 256.

order that would serve American economic and political interests. Tight relationships with the economically-advanced regions of Western Europe and East Asia had been U.S. principal overseas goals in the Cold War. The oil crisis, however, threatened to pit the industrial democracies against each other as they sought to ensure uninterrupted access to energy. Kissinger wanted energy cooperation "to break this regional autarky concept, and by getting back to some of the more cooperative conceptions which underlay our policy at earlier periods and their policy at earlier periods."[92] His new strategy should thus be seen as a *synthesis* of Cold War and economic globalization imperatives.[93]

On December 12, 1973, Kissinger unveiled his strategy to the Pilgrim Society in London.[94] The secretary of state warned that the oil shock threatened the institutions that had united the Atlantic community since the end of the Second World War. "Economic interdependence is a fact," Kissinger said, and the West needed a strategy to manage it. Kissinger proclaimed, "we strongly prefer, and Europe requires, a common enterprise." He called for the creation of an Energy Action Group to develop a program for collaboration in all areas of the energy problem to be followed by a meeting with the producer governments. The industrial

[92] "Memorandum of Conversation: Energy Conference," February 6, 1974, *FRUS, 1969-1976, vol. 36,* doc 305.
[93] My interpretation differs from Sargent in that I see Kissinger's consumer solidarity strategy as addressing both Cold War and energy threats.
[94] On November 5, 1973, Helmut Schmidt (then Minister of Finance) wrote to Kissinger suggesting that the United States convene an informal private meeting of experts within and without the major industrial nations to discuss the economic troubles plaguing them all, particularly the uncertainty in international monetary policy and the recent development in the energy field. For the letter, see Schmidt to Kissinger, November 5, GFPL, National Security Adviser Files, Kissinger-Scowcroft West Wing Office Files, 1974-77, West German (1), 4/27/73-6/11/74, Box 39. In his memoirs, Schmidt credits himself for planting the seed of the Washington Energy Conference in Kissinger's mind, writing that tensions between Bonn and Washington arising out of the controversy over Operation Nickle Grass delayed the idea's implementation. The documents do not support Schmidt's claim that his letter led to Kissinger's proposal for a consumer conference. See Schmidt, *Men and Powers*, 163. Although he may not have directly affected Kissinger's position, his belief in trilateral cooperation among the U.S., Europe, and Japan and his experience in international economics made him a leader without peer during the 1970s.

democracies rose to the challenge posed by *Sputnik* in 1957, and "the energy crisis of 1973 can become the economic equivalent."[95]

In the short-term, among the major industrial democracies, the United States alone (with the possible exception of West Germany due to its strong balance of payments position) had the ability to manage the crisis on a national basis.[96] The U.S. enjoyed technological advantages over their competitors and political clout with many of the Arab producers. Under Secretary of State for Economic Affairs William J. Casey summarized at a staff meeting:

> We will be impacted less severely by the oil price increase, because we are more nearly self-sufficient than anybody except Canada. We are going to attract a lot of investment flow–because this high price increase is going to have the effect of attracting investment towards energy activities, and we have by far the broadest base of energy activity. We have all the oil-finding technique, we have the oil drilling technique, we have the experience, we have the maps, we have nuclear energy. If you are trying to yield up energy supply, we have most of the investment assists.[97]

Despite these advantages over U.S. allies, Kissinger preferred a multilateral solution. The lessons of the 1930s motivated Kissinger's approach; he believed that if the energy crisis continued, "it portended a worldwide depression." In addition, bilateral deals would breed restrictive trade arrangements, violating one of the integral premises on which the postwar international capitalist economy had been built. Here, the memory of the Great Depression in which the world divided into rival trade blocs loomed large. The U.S. had leverage to ensure that the world did not crumble into a repeat of the 1930s. Washington enjoyed strong negotiating advantages vis-à-vis the other industrial democracies, and if the Europeans and Japanese "will not work

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[95] Kissinger, "The United States and a Unifying Europe: The Necessity for Partnership," December 12, 1973, *in DOS Bulletin*, vol. 77, December 31, 1973, pp. 777-82.
[96] William Glenn Gray, "Learning to 'Recycle': Petrodollars and the West, 1973-1975," in *Oil Shock: The 1973 Crisis and Its Econonomic Legacy*, ed. Elisabetta Bini, Giuliano Garavini, and Federico Romero (London: I.B. Tauris, 2016), 176.
[97] "Secretary's Staff Meeting, January 8, 1974," NARA, RG 59, Transcripts of Secretary of State Henry Kissinger's Staff Meetings, 1973-77, Box 2.

multilaterally, we will force them by going bilateral ourselves." The Western European and Japanese "idiots"–as Kissinger called them–needed to recognize that the U.S. acted in everybody's best interest.[98]

Policymakers in Western Europe and Japan, however, did not view the situation in the same terms. For most, there existed an inconsistency between their desire to minimize association with the American policy in the Middle East and their recognition that coping with the oil shortage required some form of cooperation with the United States. Their high dependency on foreign oil led them to a conciliatory policy toward the Arab producers. The Dutch, for example, viewed a U.S. offer to ship oil to the Netherlands as a dangerous proposition. The Dutch Foreign Office believed that the Arabs had singled the Netherlands out in the embargo, and "the U.S. was in fact doing the same thing [by offering special assistance]. We would then be in an isolated, vulnerable position, with a degree of uncertainty and pressure to which our people are mentally unaccustomed. The risks of serious damage to Dutch interests cannot be dismissed."[99] The Dutch Council of Ministers believed that assistance from the United States could also have an effect on the Netherlands' position in the Community and would have adverse consequences for European cooperation.[100] While the United States had the resources to play hardball with the Arabs, the Western Europeans did not. Pompidou commented, "We cannot afford ourselves the luxury of three or four years of trouble and misery until the Arabs understand."[101] Most reacted to Kissinger's proposal and the subsequent invitation from Nixon to

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[98] "Secretary's Staff Meeting, January 8, 1974," NARA, RG 59, Transcripts of Secretary of State Henry Kissinger's Staff Meetings, 1973-77, Box 2. Giuliano Garavini contends that the primary purpose of the Washington Energy Conference was to thwart the formation of an autonomous Community energy policy, but in the winter 1973-74, that seemed unlikely. More threatening were the bilateral deals concluded with producers in January 1974 that divided the alliance and drove up prices.
[99] "Neveneffekten van Amerikaanse oliehulp aan Nederland," December 5, 1973, NNA, 2.05.313, 14523.
[100] Ministerraad, "Notulen van de vergadering gehouden op vrijdag 7 december 1973 in het Catshuis, aangevangen 's morgens om 10 uur en 's middags en 's avonds voortgezet," December 7, 1973, NNA, 2.02.05.02, 1237.
[101] Gfeller, *Building a European Identity*, 121.

a consumer conference in Washington with vague statements of support, but they feared what kind of message it would send to the Arabs.[102] They hesitantly accepted but expressed reservations.

One of their greatest reservations was that the U.S. proposal of consumer solidarity would encourage OPEC to respond with further disruptive policies. The British Energy Department, for example, feared that the U.S. proposal "looks a little like a ganging-up of the more important consumers against the rest."[103] Many doubted that Kissinger intended to meet with the producers at all. The British had "the impression that [the Americans] wish to postpone discussion with the producers to the Greek Kalends."[104]

Indeed, they had good reason to be suspicious of Washington's motives. In late January 1974, Arthur W. Hummel, Jr., a staffer in East Asian and Pacific Affairs, told Kissinger that the Japanese (among others) worried about the U.S. posture and feared conflict. The Japanese wanted to make it "crystal clear" that consumer cooperation would not "line up a consumer front." Kissinger responded that he had said that he did not seek a united front "a hundred times, and it's bullshit….It is of course designed to create a united front. That's the only purpose of a consumer meeting. And we can waffle around this and we can say elegant things. And, of course,

[102] Nixon issued a formal invitation on January 9, 1974 to the major industrial consumer nationals to attend a meeting in Washington in mid-February to develop a concerted strategy to deal with the energy crisis "for the benefit of all mankind – producer and consumer countries alike." For a copy of the letter, see Nixon to Brandt, January 9, 1974, PA-AA, B 71, Bd. 113893 (ZA). Nixon sent the same invitations to the heads of state of Britain, Canada, France, Italy, Japan, the Netherlands, and Norway. He also sent letters to the OPEC states informing them of the conference and to assure them that his goal was not confrontation. The letter stressed the importance of the oil issue for both producers and consumers, and stated that the United States intended to a joint conference of all countries involved. For a copy, see "Text of Letter From President Nixon to Chiefs of State or Heads of Government of Members of the OPEC," UKNA, FCO 96/78.
[103] N.M. Fenn, "Nixon Proposal on Energy," January 9, 1974, UKNA, FCO 96/78.
[104] Energy Department paper, "U.S. Proposals for Long-Term Co-Operation in the International Energy Agency," November 28, 1974, UKNA, FCO 96/28.

we should say it–but, for God sakes, in a senior group here, let's not kid ourselves. The purpose is to create a consumer group that improves the bargaining position of the consumers."[105]

Fearing that further shortages might be on the horizon, the Western Europeans and Japanese scrambled to sign bilateral deals with producer governments. The *Middle East Economic Survey* in January 1974 read: "Bilateral Deals: Everybody's Doing it." The British and French took the lead, each pursuing agreements with Saudi Arabia, Abu Dhabi, and Kuwait for oil deliveries in exchange for investment and military supplies. The fact that the Arabs listed the British and French alone as "friendly" nations reinforced their eagerness to sign bilateral agreements. In early 1974, Jobert visited Iraq, Libya, and Saudi Arabia, the producers that "the positions of France and of the United States are diametrically opposed."[106] Scheel took an increasingly pro-Arab stance during visits to the Middle East, telling the Algerian and Saudi oil ministers Balaid Abdesselam and Sheikh Yamani that "the end of the territorial occupation can mean nothing else than the complete withdrawal from all occupied territories." When asked about the upcoming Washington Energy Conference, the foreign minister replied that he considered it only a first step toward the ultimate goal of a consumer-producer dialogue.[107] West Germany negotiated three bilateral deals with Iran for the construction of a refinery in Iran, natural gas and oil deliveries to the FRG, and investment in Iranian infrastructure. Japan pursued similar deals with Iran, Iraq, Saudi Arabia, and Algeria.[108] Washington fumed about these efforts, as did the Dutch; Minister for Development Cooperation Jan Pronk characterized them at

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[105] "Secretary's Staff Meeting, January 31, 1974," NARA, RG 59, Transcripts of Secretary of State Henry Kissinger's Staff Meetings, 1973-77, Box 2.
[106] Frank Costigliola, *France and the United States: The Cold Alliance Since World War II* (New York: Twayne Publishers, 1992), 179.
[107] "Wesentlicher Inhalt der Gespräche der Minister Abdesselam und Yamani mit dem Herrn Bundesminister am 17. Januar 1974," BAK, B 136/6342.
[108] "Paper Prepared in the Office of Economic Research, Central Intelligence Agency," February 4, 1974, *FRUS, 1969-1976, vol. 36,* doc. 299.

a Cabinet meeting as "disruptive" and believed "such activities make it impossible to develop a multilateral approach."[109]

The Europeans considered developing an autonomous energy policy within the Community. France in particular championed this option. At the Copenhagen Conference in December 1973, Jobert pushed for a common energy policy among the Nine and direct consultations with the Arabs. The French tended to regard U.S. strategy "as a political ploy, an attempt by Dr. Kissinger to exploit the energy crisis to institutionalise consultation with the Europeans and thus to establish an influence of their policies and decisions."[110] Simultaneously, foreign ministers from Tunisia, the United Arab Emirates, Sudan, and Algeria made official visits to Copenhagen and proposed the establishment of a formal dialogue between the members of the Arab League and the European Community.[111] At the conference, the Europeans agreed to begin a dialogue with the Arabs about a range of issues, but failed to agree on a common energy policy. Their inability to do so stemmed from divergent interests in oil, particularly the role of negotiations with the Arabs, bilateral deals, and whether the United States should be involved in the European policy. While Schmidt stressed the need for European solidarity, his British and French colleagues focused on securing their own national oil supplies.[112] Whitehall's position toward collaboration was further complicated by the fact that the British expected to become major oil producers themselves in a few years, and they did not want to sign oil sharing agreement with the Community that would give the rest of the Europeans access to British oil at low prices and deny London a windfall of profit. Later, Jobert proposed a world energy

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[109] Ministerraad, "Notulen van de vergadering gehouden op vrijdag 1 februari 1974 in het Catshuis, aangevangen 's morgens om 10 uur en 's middags voortgezet," February 1, 1974, NNA, 2.02.05.02, 1399.
[110] Tomkins to FCO, "Call on M. Balladur," February 22, 1974, UKNA, FCO 96/55.
[111] Garavini writes that the Arabs visited probably because of a French suggestion. Garavini, *After Empires*, 184-85.
[112] Gray, "Learning to 'Recycle,'" 179.

conference under UN auspices to discuss common issues and establish a foundation for cooperation between producers and consumers, adding to the number of possible schemes.[113]

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On the eve of Washington Energy Conference, there existed tremendous uncertainty about the future of consumer cooperation. Although the Americans believed that the Japanese would fall in line, they continued to worry about the Europeans.[114] Both the British and West Germans indicated that they agreed to cooperation in principle, but they also did not want to alienate the French.[115] The British, for example, sympathized and agreed with the French "on most substantive issues," including a belief in the utility of bilateral deals and the Euro-Arab dialogue.[116] The French wanted to make the conference a one-time affair, a demonstration of the hollowness of the American position.[117] Kissinger planned to present the Europeans with a choice: cooperate and adopt a multilateral strategy, or continue going into business for themselves. A collapse of the transatlantic relationship, though, threatened a core U.S. objective; "the last thing we want," Kissinger told Nixon, "is a rupture."[118] One of the central goals was to

[113] Jobert to Ratprasident, no date, as attachment to Referat III, "Vorbereitung der Konferenz über Energiefragen am 11. Februar 1974 in Washington," January 22, 1974, BAK, B 102/165168.
[114] The U.S. believed that "the Japanese are fundamentally on our side in energy matters." Although they worried about the Arabs and the domestic effects of the crisis on the eve of an election, the Japanese dependency on foreign oil from the Middle East dwarfed that of Europe and knew that they could not afford to alienate the United States. In addition, there existed no equivalent of the Nine in East Asia, and the Japanese choice was fundamentally between cooperation with the United States and the Europeans and the pursuit of bilateral deals with producers. See "Memorandum From William R. Smyser of the National Security Council Staff to Secretary of State Kissinger," February 8, 1974, *FRUS, 1969-1976, vol. 36,* doc. 313.
[115] Abteilung III/D (BMWi), "Kooperation zwischen Rohölförder – und – verbraucherländern: Initiative von Außenminister Kissinger," January 8, 1974, BAK, B 102/201371.
[116] M.D. Butler, "Political Implications of Issues Likely to Arise at the Washington Meeting on Energy," February 4, 1974, UKNA, FCO 59/1155.
[117] "Telegram from the President's Deputy Assistant for National Security Affairs (Scowcroft) to Secretary of State Kissinger in Panama," February 1974, *FRUS, 1969-1976, vol. 36*, doc. 306.
[118] "Memorandum of Conversation: Nixon, Kissinger, Shultz, Simon, and Scowcroft," February 9, 1974, RNPL, NSC Files, Presidential/HAK MemCons, January 1-February 28, 1974 [1 of 3], Box 1028.

end “the sense of panicky impotence which is now motivating [the other industrial democracies], in which everyone feels he must run for the nearest exist or assure his own supplies.”[119]

Beginning on February 11, 1974, representatives of 13 countries met for three days in the ground floor of the State Department to discuss the energy crisis. The purpose of the conference, Kissinger explained in his opening remarks, was “to resolve the energy problems on the basis of cooperation among *all* nations.” Conjuring the memory of the Great Depression, he warned that bilateral deals and increasing economic nationalism would lead to a cycle “of competition, autarky, rivalry and depression such as led to the collapse of the world order in the Thirties.” All nations–consumer and producer, rich and poor, and strong and weak–had a stake in the economic system. Kissinger unveiled his vision of what cooperation would look like, a blueprint that called for the conservation of existing energy supplies, the development of alternative energy sources, new research into possible additional sources of energy, sharing in times of emergencies and shortages, and the responsible recycling of oil revenues back into the international economy.[120]

The conference did not have an auspicious beginning for Kissinger. To his chagrin, the Europeans continued to call for close contacts with the producers. Kissinger reported to Alexander Haig that the Americans were “not getting what should be happening–response of united action. The basic theory they are not willing to buy…there is no strategic conception there.”[121] Speeches by European and Japanese policymakers including Walter Scheel (for the Nine), Douglas-Home, and Masayoshi Ohira reflected the conflicted nature of their energy policies–straddling the line between consumer cooperation and dialogue with the producers. As

[119] “Memorandum of Conversation: Energy Conference,” February 6, 1974, NARA, RG 59, Records of Henry Kissinger, 1973-77, Nodis Memcons Feb. 1974 Folder 2, Box 10

[120] “Opening Remarks of the Honorable Henry A. Kissinger, Secretary of State,” February 11, 1974, PA-AA, B 71, Bd. 113894 (ZA). Of course, Kissinger believed that his “shuttle diplomacy” to bring about a durable Middle East peace would help Western energy supplies, but this strategy fell outside the purview of consumer solidarity.

[121] “Transcript of a Telephone Conversation Between Secretary of state Kissinger and the White House Chief of Staff (Haig),” February 11, 1974, *FRUS, 1969-1976, vol. 36,* doc. 319.

expected, France took a confrontational position; Jobert "was out to torpedo the conference," Kissinger would later write.[122] In his "notably graceless" remarks, the French foreign minister declared that France would not support a consumer organization.[123] Jobert reminded the Europeans that they had agreed in Copenhagen in December 1973 about the importance of entering into negotiations with the producers, and he chastised his colleagues for breaking with this position. Instead, he reiterated the French proposal for cooperation "in every aspect between Europe and the producing countries."[124]

After the fireworks of the opening day, the Europeans met alone on February 12 to sort out the internal European position. The benefit of holding the conference was that it forced the Europeans to take a position, and Douglas-Home reported to London that "there is a strong feeling among Community delegations that the French should not be allowed to get away with it this time."[125] That afternoon, Douglas-Home reported to Kissinger that the Europeans had turned in favor of the United States. They recognized that Europe had neither the economic nor military power to solve the world's energy problems and the corresponding threats to the world's financial system. Washington alone had the ability to influence the Israelis. "We need the Americans in a way that they do not need us. It is therefore in our interest to cooperate with them," the British concluded.[126] The Europeans adopted a more pragmatic and long-term outlook on their strategy, agreeing to cooperate with the United States. There were few concrete terms to

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[122] Kissinger, *Years of Upheaval*, 913.
[123] Douglas-Home to FCO, "Washington Energy Conference," February 12, 1973, UKNA, FCO 59/1155. Jobert had come to Washington after meeting with Iraqi officials in an effort to explore opportunities for further economic cooperation between France and Iraq. See J. de Ranitz aan BZ, "Reis Minister Jobert naar Irak van 6-10 februari," February 13, 1974, NNA, 2.05.313, 14530.
[124] "Washington Conference on Energy: Statement by his Excellency Michel Jobert, Minister for Foreign Affairs," February 11, 1974, PA-AA, B 71, Bd. 113894 (ZA).
[125] Douglas-Home to FCO, "Washington Energy Conference," February 12, 1973, UKNA, FCO 59/1155.
[126] FCO to HM Embassy in Paris, "Follow-up to Washington Energy Conference," March 4, 1974, UKNA, FCO 96/55.

this agreement beyond the establishment of an energy action group to study problems, but the psychological victory was clear to the Americans.[127] "We have broken the Community," Kissinger reported to his deputy.[128] Jobert ultimately dismissed the results of the conference, saying "France's friends are elsewhere."[129]

One scholar has recently described the Washington Energy Conference as "a tepid meeting with few concrete outcomes," but the results of the conference should not be overlooked so easily.[130] Although the French refused to sign the communique issued at the end of the conference, the others agreed to establish an Energy Coordinating Group to hammer out a consumer position. This evolved into the International Energy Agency in November 1974, which would become "the decisive instrument of Western cooperation."[131] Importantly, the U.S. moved away from its initial position to meet some of the European concerns. As evidence of this, the British noted that the conference's communique eschewed "any idea of confrontation" and explicitly called for an early meeting with producers (after agreeing to a consumer stance).[132] The United States had moved "a long way towards European ideas" since Kissinger's speech at the Pilgrims Society in December 1973, including "much more recognition of the plight of developing countries."[133] The French accused their European counterparts as capitulating to the U.S. position, but this interpretation was, as the British described, "a rather absurd caricature."

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[127] "Kabinettssitzung am 20. Februar 1974," Kabinettsprotokolle 1974, Die Kabinettsprotokolle der Bundesregierung online, http://www.bundesarchiv.de/cocoon/barch/0/k/k1974k/kap1_1/kap2_8/index.html.
[128] "Transcript of a Telephone conversation Between Secretary of State Kissinger and the President's Deputy Assistant for National Security Affairs (Scowcroft)," February 12, 1974, *FRUS, 1969-1976, vol. 36,* doc. 321.
[129] Garavini, *After Empires*, 187. Gfeller notes that it is unclear whether Jobert had Pompidou's blessing to take such a combative stance at the conference. In any case, she contends that Pompidou's poor health likely gave Jobert more room to maneuver. Gfeller, *Building a European Identity*, 129.
[130] Jacobs, *Panic at the Pump*, 118.
[131] "Gespräche des Herrn Bundeskanzlers mit Präsident Carter," November 12, 1980, PA-AA, B 32, Bd. 115942 (ZA).
[132] John L. Taylor to Ronald Arculus, "Follow-up to Washington Energy Conference," 4 March 1974, UKNA, FCO 96/55. For a copy of the communique, see "Energiekonferenz von Washington, Kommunique," February 13, 1974, BAK, B 102/165168.
[133] "Record of a Meeting in Mr. J.O. Wright's Room in the FCO," February 15, 1974, UKNA, FCO 59/1156.

The conclusion of the conference represented an American compromise with the Europeans and Japanese.[134]

The success of the Washington Energy Conference almost came undone the following month, however. After the conference, Jobert had been determined to thwart the emergence of America as leader of the industrial democracies–"the Gaullist nightmare."[135] He pressed for decisions that would affirm European autonomy and distance the Nine from what he saw as the resurgence of American hegemony. He found one in the European endorsement in early March of the formation of a Euro-Arab dialogue.[136] At a press conference, a journalist asked Kissinger about his response, but the secretary of state claimed that he had not been officially informed of the announcement.[137] Nixon went so far as to make a veiled threat to withdraw U.S. soldiers from Europe if the Nine did not take American interests into consideration, claiming that Congress would not finance the troops if the Europeans continued to confront the U.S. economically.[138] The launch of the Euro-Arab dialogue sharpened the divide between the U.S. and French visions regarding the future of transatlantic relations and the proper response to economic globalization.

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The events of spring and summer 1974, however, calmed tensions. Despite Syrian and Libyan opposition, OPEC–largely because of the pressure from Saudi Arabia–announced the end of the embargo on March 18, subject to a review in early June that never took place. Saudi

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[134] This interpretation goes against those who see the Washington Energy Conference as a victory of sorts for the Americans.
[135] Kissinger, *Years of Upheaval*, 925.
[136] In his memoirs, Kissinger claims that the announcement caught him by surprise, but Gfeller shows that Europeans statesmen kept him in the loop.
[137] Kissinger, *Years of Upheaval*, 929.
[138] "Question-and-Answer Session at the Executives' Club of Chicago," March 15, 1974," *Public Papers of the Presidents*.

Arabia cited progress in Israeli-Syrian negotiations as grounds for movement.[139] The end of the embargo started the "no peace-no war" phase of the oil crisis–a return to the state of affairs that had existed prior to the October 1973 embargo.[140] Consequently, the rush to enter into bilateral agreements with the producers faded as "consumers have begun to take harder looks at the costs of bilateral deals and have apparently realized that bilateral oil may be no more secure from disruption than oil derived from major oil firms."[141] Saudi Arabia also announced that it would increase production by one million barrels a day, which helped stabilize prices. The cost of energy continued to be a burden across the world, but the use of oil as a political weapon ended for the time being.

Furthermore, a new group of leaders across the major Western countries emerged who worked well together and adapted to the realities of the economic system. In the early 1970s, the leaders of the four transatlantic powers failed to forge meaningful and cooperative working relationships. Each of them–Nixon, Heath, Pompidou, and Brandt–pursued objectives that often put him at odds with his allies. Despite his repeated declarations that he was strongly pro-European, Nixon enacted policies and took positions that ignored European concerns. On the other side of the pond, Heath's longstanding dedication to British entry into Europe, Pompidou's pseudo Gaullism, and Brandt's preoccupation with *Ostpolitik* reinforced the breakdown of transatlantic relations in the early 1970s. Each also had a personality that did not mesh well with the others; Nixon's and Heath's brooding nature in particular were legendary. Brandt had a

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[139] Salim Yaqub, "The Weight of Conquest: Henry Kissinger and the Arab-Israeli Conflict," in *Nixon in the World: American Foreign Relations, 1969-1977, ed. by Fredrik Logevall and Andrew Preston* (New York: Oxford University Press, 2008), 238.

[140] Mendershausen divides the history of the energy crisis into phases. The "ambush" phase began with the production cuts and embargo in October 1973. After the supply cuts ended, the "no peace-no war" phase started during which the industrial democracies had to adjust to the new economic realities. Mendershausen, *Coping with the Energy Crisis*.

[141] "Conversation Between President Nixon and the President's Assistant for National Security Affairs (Kissinger)," February 3, 1973, *FRUS, 1969-1976, Volume E-15, Part 2,* doc. 6.

throat operation that left him bedridden, and when Nixon asked Kissinger about the chancellor's health, the secretary of state answered, "unfortunately, he's likely to hang on in there." Nixon responded, "He is a dolt."[142]

In the span of only a few months in mid 1974, however, those four heads of state left office. In their places rose pragmatic leaders who had backgrounds in economics and eschewed the parochialism of their predecessors. They also prioritized the transatlantic relationship. After Harold Wilson defeated Heath in the national election in February, the new prime minister turned away from his Heath's predilection to side with France to gain entry into the EC and reestablished Britain's traditional postwar role as a mediator between the United States and Europe. Pompidou passed away in early April, and his successor (after a month-long interregnum) Giscard abandoned the confrontational foreign policy that Pompidou and Jobert developed (the replacement of the unpopular and bellicose Jobert with Jean Sauvagnargues was perhaps more important). Following the accession to power of Giscard and Sauvagnargues, the State Department noted that "acerbic references toward US policies have been absent and a more pragmatic, unemotional approach to our relations is evident."[143] Helmut Schmidt–who took power in May after in an internal *Machtwechsel* when Brandt resigned in the wake of an espionage scandal–had a wealth of experience as former Minister of Finance, Economics, and Defense. Schmidt's grasp of the complexities of international economic policy made him perhaps the most capable statesman of his era in dealing with the new challenges of economic globalization. Finally, Nixon–who had been consumed by the Watergate scandal and had left foreign policy mostly in the hands of Kissinger–resigned the presidency in August. The new

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[142] Douglas Brinkley and Luke A. Nichter, *The Nixon Tapes, 1973* (New York: Houghton Mifflin Harcourt, 2015), 41.
[143] State Department, "Paper for the Secretary's Briefing of the President," August 21, 1974, GFPL, NSA, Pres, Country Files Europe, France (1), Box 3.

American president Gerald Ford had an economics degree from the University of Michigan and had a reputation of working collegially with his colleagues in Congress.

This personable and pragmatic group led the industrial democracies through the crises of the mid 1970s, displaying a high degree of trust and confidence in one another. As Schmidt writes in his memoirs, "There was no doubt about the joint 'grand strategy,' there were no mutual suspicions and bitterness, and there was confidence in a moderately imposed American leadership that forebore playing out its role in public." When the four met in the Colorado mountains after they had all left office, the conversation sometimes turned to their cooperation in the 1970s and "one or another of us, feeling somewhat melancholy–and at the same time a little arrogant–might say, 'of course in those days the world was better governed than it is now.'"[144]

The hostility that had characterized the industrial democracies' response to the energy crisis thus disappeared, but there still remained substantive differences between the U.S. and French positions–particularly with respect to consumer relations with the Arabs. Despite American reservations, the first Euro-Arab dialogue meeting took place in June in Paris, and in September the European Council voted to create a common European energy policy.

Seeking to regain the initiative on the energy front, on October 24, Giscard called for a conference to take place in early 1975 involving about a dozen countries that represented the producers, consumers, and developing nations. Western Europe, Giscard proposed, should be represented as a single bloc unified behind a single policy. He again stressed his opposition to France adding its signature to the U.S.-led oil-sharing agreement, arguing that such a treaty

[144] Schmidt, *Men and Powers*, 175. Representative of his respect for the American president, Schmidt titled this chapter "My Friendship with Gerald Ford." In contrast, he did not develop the same level of mutual trust and confidence with Ford's successor, Jimmy Carter, whom Schmidt found naïve and foolish. Schmidt titled his chapter on Carter "Jimmy Carter: Idealistic and Fickle." Schmidt's admiration for Ford was mutual; Ford writes in his memoirs that the two got along very well, and "we called each other by our first names, we joked with each other, and saw eye to eye on almost everything." In addition, "to a degree that at first surprised and then delighted me, the same was true of my relations with French President Valery Giscard d'Estaing." *Ford, A Time to Heal*, 221.

would inevitably lead to confrontation. Together, the developed and developing worlds should study the problem of prices, oil revenues, and resource availability. He called for indexation of oil prices, whereby the price of OPEC oil would be tied to the prices of Western manufactured goods.[145] As the scholar Guliano Garavini contends, Giscard did not want to redistribute resources to the global South, as more militant proponents of the NIEO advocated. Instead, he sought the creation of new mechanisms that would stabilize the monetary and energy fronts of the global economy.[146]

Kissinger answered Giscard's proposal with his own speech at the University of Chicago on November 14. He repeated the importance of consumer solidarity and renewed calls for conservation and research into alternative fuel sources. Only these measures, Kissinger maintained, could alter the energy landscape and secure acceptable market conditions for the consumers. Importantly, he also left open the door for American participation in a consumer-producer conference, but only after consumer solidarity had been developed, and there are realistic prospects for significant progress, the US is prepared to participate in a consumer-producer meeting."[147] This represented a slight change in Kissinger's policy and showed a willingness to compromise with the French.

The visions of Giscard and Kissinger placed the Europeans once again in a familiar bind. They tended to agree with Kissinger's analysis of the problem and sought to ensure continued American leadership of the producers. Recognizing that hard times may be ahead, the British, for example, acknowledged their interest in "keeping on an inside track with the US administration:

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[145] "Giscard Asserts World is in Grip of Fiscal Crisis," October 25, 1974, *New York Times*. This proposal built on the ideas of Saudi Arabian Energy Minister Sheikh Yamani.
[146] Garavini, *After Empires*, 195.
[147] "The Energy Crisis: An Address by U.S. Secretary of State, Henry A. Kissinger," November 15, 1974, UKNA, Foreign and Commonwealth Office (FCO) 96/28.

we may need their help in hard times ahead." Although France and two others abstained, the OECD council voted on November 18 to create an International Energy Agency to coordinate consumer policies on the energy front.

The Europeans also belonged to the Euro-Arab dialogue, however, and feared that moving too close to the United States would undermine that conversation. Aspects of Kissinger's proposal appeared to London as "unnecessarily provocative," particularly Kissinger's tactic of framing the purpose of the conference as focusing on oil prices only.[148] The British also worried that the new U.S. hardline attitude on prices may weaken the resolve of some of the Western Europeans to proceed with the IEA. Egerton feared, "The bathwater could get too warm for the baby. Any sign that we were less than whole-hearted in our support for the scheme could undermine the will of others to underwrite it."[149] In this sense, Giscard's view appealed to them.

Instead of choosing between the Washington and Paris, the Europeans sought to facilitate a compromise. The majority of the IEA had "a strong desire to achieve a collective middle way between the Giscard and Kissinger approaches." On November 19, the Belgian Chairman of the IEA Étienne Davignon suggested that this might be achieved "by adopting the tactic of 'parallelism,'" whereby the consumers would strengthen their commitment to consumer objectives while also showing a readiness to take the views of the producers into consideration. The British recognized that the West Germans and Japanese were interested in taking the lead in bridging the gap between the Americans and French, and London was content to stay on the

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[148] Energy Department paper, "U.S. Proposals for Long-Term Co-Operation in the International Energy Agency," November 28, 1974, UKNA, FCO 96/28.
[149] S.L. Egerton, "International Energy Programme Review," October 7, 1974, UKNA, FCO 96/23.

sidelines.[150] Schmidt ultimately acted as a mediator between the U.S. and French, and carried messages between the two sides.[151]

Finally, in December the U.S. and France managed to reconcile their differences at a bilateral summit in Martinique, a French-controlled island in the Caribbean.[152] Sauvagnargues told Kissinger and Ford that "Giscard comes here with a sort of mandate to reconcile our positions." He said that the French agreed about the importance of the consumers developing a common position, but wanted further clarification about what that entailed. Kissinger repeated the American position, arguing "consumer organization is a way to give the consumer nations a sense of control of control over their destiny." The secretary of state admitted that consumer solidarity would not lower prices, but it would bring the industrial democracies together. France did not have to join the IEA; "We can work on parallel paths," Kissinger told Giscard and Sauvagnargues. The French foreign minister responded that emergency sharing protocol would look like confrontation, but he agreed to cooperate as long as the French did not have to announce it publicly. The Americans agreed to participate in a preparatory meeting between producers and consumers in March 1975 to develop an agenda and procedures for a main conference in July 1975. In return, the French accepted the need to take "actions by consumers sufficient to guarantee cooperation," including implicit cooperation on parallel paths with the IEA on conservation of energy and the development of alternative fuels.[153]

[150] Energy Department brief, "The Approach to Consumer-Producer Negotiations," December 3, 1974, UKNA, FCO 96/28.
[151] Referat 403, "Gespräche des Herrn Bundeskanzlers und des Herrn Bundesministers mit Präsident Ford und Außenminister Kissinger am 4. und 5. Dezember 1974," December 2, 1974, PA-AA, B 32, Bd. 101376 (ZA).
[152] In his memoirs, Ford describes his first meeting with Giscard and Sauvagnargues in Martinique, remembering that he liked the Frenchmen immediately. He and Kissinger went swimming with their French colleagues, an activity that contributed to the informality of their first encounter (Ford perhaps diplomatically describes seeing Kissinger in a blue bathing suit as "a novel experience"). Ford, *A Time to Heal*, 222.
[153] "Memorandum of Conversation – Ford, Kissinger, French President Valery Giscard d'Estaing, Foreign Minister Jean Sauvagnargues (Meeting 1)," December 15, 1974, GFPL, National Security Adviser's files, Memoranda of Conversations, 1973-77, Box 8.

The U.S.-French rapprochement opened a new era in the Atlantic Alliance. It opened the door for cooperative creative policymaking to confront the emerging challenges of economic globalization. Building on the progress at Martinique, Schmidt wrote Ford, Giscard, and Wilson in late December to propose a private meeting the following month of no more than 15 independent experts to discuss the current problems in the global economy. The meeting would take place in the anonymity of a large city such as Hamburg, Munich, or Frankfurt, and cover the explosion of the oil prices, monetary policy, trade issues. The experts, independent of government interests, could discuss solutions to common problems. They later could meet with experts from Iran, Saudi Arabia, Algeria, and Venezuela to develop tactics to confront issues in the global economy that affected both the developed and developing world.[154] This meeting set a precedent for economic summitry among the industrial democracies beginning in 1975.[155]

Together, the industrial democracies set out to meet the challenges of the growing economic insurgency from the global South and the malaise that permeated Western economies. The Martinique Summit did not signal the end of transatlantic disagreement about how to manage the portentous implications of economic interdependence, but it did mark the beginning of a constructive dialogue. Consumer solidarity would not reduce the price of oil, Kissinger noted to the Frenchmen, but it would ensure that the West would hold together as a unit. In an era of decreased tension with the Soviet Union, the West began to use the pursuit of common economic interests to maintain its cohesion. The industrial democracies worked on parallel paths–one track emphasizing consumer solidarity and the other stressing direct contacts with the producers. They set out to engage and confront the global South to combat the establishment of a

[154] Bundeskanzler Schmidt an Präsident Ford, December 23, 1974, *AAPD 1974, Bd. 2*, doc. 382.
[155] This is a topic that will be discussed at length in the following chapter.

new international economic order and stabilize a global capitalist economy that could no longer be managed on a unilateral basis.

Chapter 4

"If We Don't Defend the Free Market, I Ask You, Who Will?": The Neoliberal Turn of the Mid 1970s

The twin shocks of the collapse of Bretton Woods and the energy crisis served as the chief catalysts for the end of the postwar economic international system, calling into question the future of Western institutions. They accelerated an inflationary spiral, increased unemployment, unnerved financial markets, and precipitated an economic insurgency of the developing world against the West. Each of these fronts reinforced the other, and a sharp recession descended on the capitalist world in late 1974. West German Chancellor Helmut Schmidt and French President Valéry Giscard d'Estaing agreed that "the greatest threat to the West is not the Communists or the Southern flank of NATO, but the economic ability of the West."[1] The cover of *Time* magazine asked in July 1975: "Can Capitalism Survive?"[2]

This chapter explores the economic and financial challenges that the industrial democracies faced in the mid 1970s, and the strategies that they developed to stabilize and adapt economies that fell under attack. The industrial democracies struggled with each other and the global South to manage an international economic order in transition and whose future terms were up for grabs. The global economic malaise cast doubt over the legitimacy of Western institutions, but it also offered an opportunity to remake the structure of the international economy. "We stand at a watershed moment," U.S. Secretary of State Henry A. Kissinger told journalist Bill Moyers in a January 1975 television interview. "We live in a period that in hindsight will either be viewed as a time of extraordinary creativity or as a time in which the

[1] "Memorandum of Conversation," July 12, 1975, *Foreign Relations of the United States (FRUS), 1969-1976, Foreign Economic Policy, 1973-1976,* vol. 31, doc. 94.
[2] Cover, July 14, 1975, *Time*, vol. 106, no. 2.

international order was divided politically, economically, and morally."[3] The management of accelerating economic globalization loomed as one of the chief challenges for policymakers, and each state sought to harness the patterns of change in the political economy to its advantage.[4]

This chapter argues that U.S. and West German policymakers forged an effective framework for the development of neoliberalism in the mid 1970s. Neoliberalism refers to a broad set of principles that promoted free trade, privatization, reductions in government budgets, the rollback of state interference in the economy, and deference to the free market. It represented a rebellion against the welfare state that had existed since the end of the Second World War. Washington and Bonn sought to limit state interference and empowering markets. They believed that high levels of spending contributed to inflation, and markets could promote economic growth better than the state. Schmidt concluded, "the root of all current evils was the failure to get a grip on inflation; in these circumstances, traditional Keynesian economics were irrelevant."[5]

The turn to neoliberalism was hardly foreordained; U.S. and West German policymakers needed to create an environment in which it could thrive.[6] Other scholars have had much to say

[3] A German-language transcript of the January 16, 1975 interview can be found in Bundesarchiv-Koblenz (BAK), Koblenz, Germany, B 136/8039.
[4] Beginning in 1968 with the publication of Richard Cooper's *The Economics of Interdependence*, academics began exploring the effects of economic interdependence on international relations. They used the term "economic interdependence" in a way that scholars today use economic globalization. For a brief description of this literature, see Daniel J. Sargent, *A Superpower Transformed: The Remaking of American Foreign Relations in the 1970s* (New York: Oxford University Press, 2015), 167-70.
[5] In response, British Foreign Secretary Anthony Crosland quipped that Schmidt's "tone was apocalyptic and a little hectoring and his views miles to the right of Mrs. Thatcher!" "Draft: Record of a Meeting of the European Council Held at Binnenhof, The Hague on Monday 29 November 1976 at 1500," UKNA, PREM 16/851.
[6] In particular, the literature on the diplomacy of the Ford administration is underdeveloped. Historians tend to treat the period as merely an extension of the Nixon years, choosing at times to refer to 1969-1977 as the Nixon-Kissinger years. The similarities between the Nixon and Ford administrations are undeniable (not least because of the influence that Kissinger wielded under both presidents), but Ford faced a different set of challenges during his two-and-a-half years in office and deserves to be evaluated on his own terms. He developed a free-market approach to the economic problems that set the tone for four decades of US foreign policy. A prominent collection of essays edited by Fredrik Logevall and Andrew Preston is titled *Nixon in the World: American Foreign Relations, 1969-1977* (New York: Oxford University Press, 2008). Moreover, the enormous literature on Kissinger focuses on his time as national security adviser under Nixon, particular his role in the rise of *détente* with the Soviet Union,

about the structural reasons for the "neoliberal turn," but few have explored the international politics that led to it.[7] Indeed, the international economy could have moved in a variety of different directions, and Washington and Bonn had to defeat alternatives. They helped end the postwar consensus about the dominance of the state's role in the market. They worked to protect market forces and keep statism at bay. A battle waged between the left and the right, and for the first time since the end of the Second World War, the right began to win.

This chapter identifies three cases in the mid 1970s. First, neoliberals confronted the insurgency of the global South after the oil crisis. The oil shock gave the developing world a

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rapprochement with China, and shuttle diplomacy in the Arab-Israeli conflict. For a leading works, see Jussi Hanhimäki, *The Flawed Architect: Henry Kissinger and American Foreign Policy* (New York: Oxford University Press, 2004); Walter Isaacson, *Kissinger* (New York: Simon & Schuster, 2005); Jeremi Suri, *Henry Kissinger and the American Century* (Cambridge, MA: Harvard University Press, 2007). In his chapter on U.S. relations with the global South during the 1970s, Mark Atwood Lawrence virtually ignores the policies of the Ford administration, choosing instead to examine the Nixon, Carter, and Reagan presidencies only. This is a puzzling omission because the Ford administration participated in the North-South dialogue and felt the brunt of the developing world's insurgency against Western institutions. See Lawrence, "Containing Globalism: The United States and the Developing World in the 1970s," *The Shock of the Global: The 1970s in Perspective*, ed. by Niall Ferguson, Charles S. Maier, Erez Manela, and Daniel J. Sargent (Cambridge, MA: Harvard University Press, 2010), 205-19. An exception that explores U.S. foreign policy during the Ford administration is the growing literature on the rise of human rights and the Conference on Security and Cooperation in Europe in 1975, which often chastises Kissinger for his hostility to the intrusion of human rights into international politics.

This chapter makes a similar contribution to the literature on Helmut Schmidt. Often forgotten between between Willy Brand and Helmut Kohl, Schmidt deserves recognition for his contributions to West Germany and international relations more broadly. Because of his extensive background in government – including stints as minister of economic and finance – Schmidt was the single most capable statesman of his era in dealing with the global economic challenges of the 1970s. His creative policymaking provided the framework for the G7 summits and international cooperation to solve common economic problems. This argument comports with a couple recent works on Schmidt that emphasize his enormous contribution to European and transatlantic relations. See, for example, Mathias Haeussler, "A 'Cold War European'? Helmut Schmidt and European Integration, c. 1945-1982," *Cold War History* vol. 15, no. 4 (2015): 427-47; and Kristina Spohr, *The Global Chancellor: Helmut Schmidt and the Reshaping of the International Order* (New York: Oxford University Press, 2016). This chapter, however, expands on these arguments by adopting a global perspective. In her well-researched section on international economics, for example, Spohr provides an excellent analysis of Schmidt's significant contribution to the birth of the G7 economic summitry, but she ignores other equally important economic developments in the mid 1970s, particularly the lingering effects of the oil crisis and petrodollars, the North-South dialogue, and the reconstruction of the international monetary system.

[7] This argument comports with arguments in Eric Helleiner's *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca, NY: Cornell University Press, 1994) and Christopher W. Dietrich's recent article, "Oil Power and Economic Theologies: The United States and the Third World in the Wake of the Energy Crisis," *Diplomatic History* vol. 40, no. 3 (2013): 500-29. It advances it, however, by expanding the scope to include West German policymakers as equal players. With the strength of the West German economy and Bonn's influence within the European Economic Community, the West Germans had opportunities to support the state-centric models of their European colleagues, particularly the French and the British.

sense of empowerment, and postcolonial elites demanded a greater share of global wealth and influence in international institutions. U.S. and West German policymakers balked at their proposals, refusing to agree to demands that would make high raw materials prices a permanent feature of the global economy. They exploited the division between the oil-producing and non oil-producing countries in the developing world to break the "unholy alliance between the LDCs and OPEC."[8]

Second, U.S. and West German policymakers implemented neoliberal solutions in the fields of finance and international monetary policy. The oil crisis created enormous profits for the members of the OPEC, and the Western financial system offered the most attractive place for them to invest. The U.S. and West Germans wanted the free market to decide where OPEC's surplus should be invested, so that capital would go where it would be most productive, not where governments thought it was most needed. They believed that the flood of "petrodollars" into the financial markets would lead to disruptive financial flows across borders, and they rejected a French push to return to Bretton Woods. Instead, they legalized floating exchange rates.

Third, the British IMF crisis of 1976 marked a decisive turning point in which Washington and Bonn imposed neoliberalism on the British welfare state through the IMF. Foreign holders of sterling lost confidence in the currency, and the situation demanded that the British make cuts at home to reassure them that they would protect sterling. The Labour government under James Callaghan, however, believed that its ability to govern rested on its relationship with the trade unions, and a commitment to full employment was a chief goal of the British welfare state. In the fall of 1976, a showdown took place between the forces of

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[8] "Memorandum of Conversation," November 16, 1975, FRUS, 1969-1976, vol. 31, doc. 124.

neoliberalism and the welfare state. When the IMF insisted on strict conditionality in return for a loan, the British were forced to make budget cuts, turning their back on the statist ideology that had guided the country since the Second World War.

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The first arena of competition came in the form of the North-South dialogue. As the postwar international order crumbled, the global South seized an opportunity to demand the transformation of the global economy. For decades, the developing world had unsuccessfully demanded sovereignty over their raw materials and a greater stake in the international economic system, but the oil shock of 1973 thrust North-South issues into the spotlight. The oil producers had seized full control – within their own economies – of an irreplaceable commodity that was essential to the economic vitality of the industrial democracies.[9] Members of the developing world sought to harness OPEC's momentum by turning the oil weapon into a more comprehensive platform to force the redistribution of wealth from the developed to the developing world, and to adapt Western institutions to make them more amenable to the global South's interests.[10]

Drawing on a prior initiative at the Algiers Summit in September 1973, Algerian Secretary of the Non-Aligned Movement Houari Boumédiène called on the United Nations to convene a special assembly to discuss issues related to trade and raw materials.[11] At the Sixth Special Session of the U.N. in April 1974 (the first such meeting to deal exclusively with economic issues), Boumédiène denounced the West for "cling[ing] to their position of

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[9] Planning Staff paper, "The New International Economic Order," January 22, 1975, UKNA, FCO 49/573.
[10] Dietrich, "Oil Power and Economic Theologies," 501.
[11] Garavini, *After Empires*, 177-78. For the conclusions reached at the Algiers Summit that advocated economic justice and emancipation for the developing world, see "Documents of the Fourth Conference of Heads of State or Government of Non-Aligned Countries," September 5-9, 1973, available online at: http://cns.miis.edu/nam/documents/Official_Document/4th_Summit_FD_Algiers_Declaration_1973_Whole.pdf.

dominance over world resources" and overseeing an economic system based on colonial and neocolonial control over the developing world.[12] With the numerical strength of the developing world in the U.N., the General Assembly approved the "Declaration on the Establishment of a New International Economic Order," an initiative that committed the international community to reconstructing the economic system to protect the equality of all states and the "permanent sovereignty over its natural resources and all domestic economic activities."[13] The demands of the Group of 77 included a more control of foreign investment, increasing purchasing power of their exports (particularly raw materials), better access to the markets of the developed countries, increased development aid and technology transfers, alleviation of national debt, and increased influence in the U.N. and Western-controlled institutions such as IMF and World Bank.[14] Boumédiène included the producers as oppressed members of the developing world. He asked a British Foreign Office representative, "What wealth does Saudi Arabia…really have? Just dollars in foreign banks. Where is its industry and its modern society? What guarantees does it enjoy?"[15]

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[12] "Statement by President Hoari Boumediene, President of the Council of the Revolution and of the Council of Ministers of the Democratic and Popular Republic of Algeria. Extraordinary session of the General Assembly of the United Nations," April 1974, UKNA, FCO 96/161.

[13] The term "Group of 77" referred to the title dating from the second UNCTAD meeting in 1968 in New Delhi when the developed nations numbered 77. By the time of the Sixth Special Session of the UN, their numbers swelled to almost 100. For a copy of the "Declaration on the Establishment of a New International Economic Order" written by the Group of 77 and approved by the U.N., see UKNA, FCO 96/161.

[14] Hart, *The New International Economic Order*, 33.

[15] "Record of Conversation Between Minister of State for Foreign and Commonwealth Affairs the President of Algeria: New York, 8 April 1974," April 19, 1974, UKNA, FCO 96/161. For an introduction to the nature of the developing world's challenge, see Jeffrey A. Hart, *The New International Economic Order* (New York: St. Martin's Press, 1983); Michael Hudson, *Global Fracture: The New International Order* (Ann Arbor, MI: University of Michigan Press, 2003); and Stephen Krasner, *Structural Conflict: The Third World Against Global Liberalism* (Berkeley and Los Angeles: University of California Press, 1985); The global South included the Eastern bloc in its demand for a redistribution of wealth and called on the socialist countries to join the dialogue as part of the industrial North. Unsurprisingly, the Soviet Union refused to participate. A Soviet spokesman at the U.N. claimed, "We're not responsible for their problems – we never had any colonies….We started out under colonial conditions ourselves, so why should we pay?" Don Shannon, "Have-Not Nations Hope to Flex Muscles at U.N.: Producers of Raw Materials to Adopt Oil Nations' Tactics," April 7, 1974, *Los Angeles Times*, p. E1. The British speculated that race also contributed to Soviet reluctance to making material and financial contributions to the developing world. In conversations with the British, the Soviets privately questioned "whether it was in the interests of the 'North', whether East or West, to transfer real resources to the coloured peoples of the developing world – to the detriment of the needs of the white peoples of the North." Planning Staff Paper, "The North/South Dialogue and the Soviet

The specter of the formation of additional cartels also loomed, particularly in the areas of copper, tin, nickel, cobalt, aluminum, sugar, coffee, tea, beef, and rubber.

The West did not know how to counter the NIEO. The industrial democracies, of course, had been fending off such ideas since the Bandung Conference. The oil crisis, however, was transformative because now oil producers in the global South held the power to disrupt the Western economies. After the oil crisis, the industrial democracies, a U.S. official wrote, had come "out of the fire and into the frying pan."[16] Oil was the only issue that the industrial democracies wanted to discuss. They struggled to finance their oil imports and the specter of further price hikes loomed. OPEC controlled a large proportion of total world oil production, and this meant that the reserves of the consuming countries were nowhere near sufficient to withstand another coordinated assault on the market.[17] The industrial democracies enacted domestic energy conservation programs and expanded development efforts for alternative sources such as nuclear energy, but these could not provide immediate relief.[18] Because the

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Union," November 17, 1977, UKNA, FCO 49/739. The NIEO, however, provided a battleground between the Soviet Union and China for the upper hand in the competition for the Third World. China in particular came out strongly in support of the NIEO, and Dung Xiaoping made his famous "Three Worlds" speech in the NIEO forum. On the effect of the NIEO on the Soviet-Sino rivalry, see Jeremy Friedman, *Shadow Cold War: The Sino-Soviet Competition for the Third World* (Chapel Hill, NC: University of North Carolina Press, 2015), 206-14.

[16] Douglas Greenwald, "A Second Look at the Energy Problem – 1974-76," August 2, 1974, Gerald R. Ford Presidential Library (GFPL), Ann Arbor, MI, Arthur Burns Papers, 1969-78, Testimony: JEC, Nov. 27, 1974; Background Material – Energy, Box E17. Oil prices stabilized after March 1974. In early March, Saudi Arabian oil sold for $9.30 per barrel. It rose to $10.56 per barrel by the end of the year, but this was a relatively modest increase. See Lieber, *The Oil Decade*, 21.

[17] Planning Staff paper, "The New International Economic Order: Annex A," January 1975, UKNA, FCO 49/573. For a contemporary estimate of the effect of the oil crisis on the balance of payments of the industrial democracies, see CIA Office of Economic Research to Alex Lang, "The Effect of Oil Costs on OECD Trade Balances in 1974," October 7, 1974, CREST. Kissinger quipped to the Dutch Foreign Minister Max van der Stoel, "The developing countries clearly want a new economic order. Our economic people want an endorsement of the existing order. It's a boring debate." "Memorandum of Conversation," August 11, 1976, National Archives and Records Administration II (NARA), College Park, MD, RG 59, Records of Henry Kissinger, Nodis Memcons August 1976 3 of 3, Box 17.

[18] Promises to conserve energy did not impact each country the same. 69 percent of oil consumption in the United States, for example, was for private use while 31 percent was for industrial purposes. In Japan, the almost the opposite was true: 27 percent of oil consumption was for private use and 73 percent was for industrial production. Furthermore, it did not have reserves of coal like the United States and the Community did, so it depended on oil for the vast majority of its energy consumption. Therefore, Japanese Prime Minister Kakuei Tanaka told Ford and Kissinger, "any conservation program would automatically mean an immediate reduction of industrial production in

radical members of OPEC – including Algeria, Libya, and Iraq – supported the NIEO, the industrial democracies could not dismiss it if they wanted to discuss oil prices.[19] The main problem for the industrial democracies was that there existed an implied link between lower energy prices and steady supply, and concessions from the West on NIEO topics.[20]

The industrial democracies shared a common interest in securing a steady supply of oil at a reasonable price.[21] How to achieve this objective in the context of the NIEO, however, divided the industrial democracies. In Washington, policymakers pursued a dual strategy based on confrontation and engagement. The Treasury spearheaded the confrontation approach. Free-market proponents such as Secretary of the Treasury William E. Simon strongly opposed any accommodation with the global South. An unyielding advocate of the free market, Simon had enjoyed a successful career as a Wall Street banker before entering government service during the Richard Nixon administration. After succeeding George Shultz as Treasury Secretary in May 1974, Simon earned a reputation as an uncompromising proponent of laissez-faire policies. In May 1975 during a Cabinet meeting to discuss the NIEO, Simon asked, "the world economic

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Japan." Ford and Kissinger responded that conservation efforts reinforced the broader objective of consumer solidarity and that it would ultimately help the IEA's bargaining position vis-à-vis the producers. Furthermore, they planned to invest in alternative sources of energy – including nuclear, solar and geothermal – that would limit dependence on oil as an energy source. Because of Japan's reliance on oil, Tanaka welcomed this R&D initiative and urged that all of the industrial democracies participate. "Memorandum of Conversation," November 19, 1974, FRUS, 1969-1976, vol. 37, doc. 19.

[19] Not all of OPEC shared the goal of the NIEO, but conservative members of OPEC such as Saudi Arabia and Iran that did not seek a radical transformation of the international economic order had "difficulty in opposing outright [Algerian] demagogic appeals. "Memorandum From Robert Hormats of the National Security Council Staff to Secretary of State Henry Kissinger," March 4, 1975, FRUS, 1969-1976, vol. 37, doc. 47. On the radical oil producers, see Luis Martinez, *The Violence of Petro-Dollar Regimes: Algeria, Iraq, and Libya* (New York: Columbia University Press, 2012).

[20] Gerald L. Parsky to William E. Simon, "Producer/Consumer PREPCON," April 28, 1975, NARA, RG 56, Office of the Under Secretary for Monetary Affairs, Records of Assistant Secretary for Trade, Energy, and Financial Resources, Policy Coordination Gerald L. Parsky, Energy: PrepCon, Box 1.

[21] In December 1975, the Soviet Union proposed an international conference on energy, transportation, and the environment. Brezhnev's proposal was met with derision from the industrial democracies, which believed that it constituted a ploy to distract world opinion from the fact that the Eastern countries from Soviet inaction in other areas. Referat 402, "Vorbereitung des KSZE-Folgetreffens in Belgrad; Behandlung der Breshnew-Vorschläge über gesamteuropäische Konferenzen über Umwelt, Energie und Verkehr," May 11, 1977, Politisches Archiv des Auswärtigen Amts (PA-AA), Berlin, Germany, B 71 (ZA), Bd. 121261.

order is a broad effort on an issue of principle, which is in opposition to U.S. interests. If we don't defend the free market, I ask you, who will?"[22] Simon wanted to stonewall the NIEO, believing that oil prices would come down "if we just let the market work."[23]

More cognizant of politics, the State Department wanted to avoid open confrontation. Kissinger recognized that refusing to engage in dialogue with the global South would only strengthen the NIEO and alienate U.S. allies. Kissinger agreed with the Treasury about the overarching objective of protecting the free market and defeating the NIEO, but Kissinger's growing sensitivity to matters of political economy caused him to question Simon's rigid tactical approach. The secretary of state feared that this would only unite the LDCs. "We can't do this on a theological basis," Kissinger said. "The LDCs will unite and the developed countries will split up." He recognized that if the U.S. "went to the barricades" and refused to negotiate with the developing world, it would be isolated and "beaten back and back." Instead, Kissinger wanted to sidestep the question of the NIEO and "fight on technical issues." "Obviously, we can't accept the new economic order, but I would like to pull its teeth and divide these countries up, not solidify them."[24]

Kissinger believed that this strategy would also help unite the West. He continued to work through the International Energy Agency (IEA) to build consumer solidarity. Kissinger understood that the European dependence on foreign oil meant that European policymakers

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[22] "Memorandum of Conversation," May 26, 1975, FRUS, 1969-1976, vol. 31, doc. 294.
[23] "Memorandum of Conversation," February 3, 1975, FRUS, 1969-1976, vol. 37, doc. 39. See also William E. Simon, "Memorandum for Members of the Executive Committee of the Economic Policy Board: Oil-related Economic Issues," October 29, 1974, David Bishop Skillman Library, Lafayette College, Easton, PA, William E. Simon Papers, Series IIIB, Drawer 25, Folder 36. One of the only major area where the United States did not pursue a free-market policy was in regards to the floor price of oil. Against the wishes of Simon, Kissinger supported it, believing that it would protect investment in alternative sources of energy. Ford approved the position. See "Memorandum of Conversation," May 21, 1975, NARA, RG 59, Records of Henry Kissinger, Classified External Memcons, May-December 1975 (Folder 1), Box 23.
[24] "Memorandum of Conversation," May 26, 1975, FRUS, 1969-1976, vol. 31, doc. 294.

could not reject the NIEO outright, but he also knew that the Europeans did not want the NIEO to succeed. Challenging the NIEO on technical issues would allow the Europeans to engage the global South in dialogue but not make concessions. Schmidt, for example, privately told Kissinger that he could no longer back the U.S. on strictly ideological grounds due to the reaction among oil-producing states, but Kissinger believed that Schmidt "will support free enterprise in the end, when the chips are down." The key was to ensure that the discussions hinged on technical issues rather than ideology: "On practical issues Schmidt will support us nine out of ten times. On ideological issues, he will be pushed by the French and others."[25] Shifting the conversation of the NIEO from ideology to technical issues, Kissinger thought, would help unite the West.

Indeed, the Europeans also feared a radical transformation of the economic system that would empower the global South at their expense, but their dependence on foreign oil made them more amenable to coming to terms. At the Lomé Convention in February 1975, the Community reached an agreement with 71 postcolonial countries that allowed agricultural exports to enter Europe duty-free and the Community committed several billion dollars of aid. Led by the French, the Europeans continued to push for increased contacts with the developing world, particularly oil producers. They believed that the establishment of the Euro-Arab dialogue in spring 1974, for example, offered benefits for both sides. For the Europeans, it would allow them to develop close contacts with the oil producers to ensure a steady flow of energy to run their economies. Given Paris' leadership role in establishing the dialogue, its success would also give France improved international standing, showing the world that the French could pursue their own foreign policy independent of Washington – a vision shared by all French policymakers,

[25] Ibid.

Gaullist and communist alike.[26] The French desire for an independent foreign policy was not lost on Kissinger; he complained that European diplomats – particularly French – kept referring to the establishment of the Euro-Arab dialogue as a victory in the "heroic battle" against the United States.[27] For the Arabs, the dialogue would facilitate the transfer of Western technology and manufactured goods. It would also provide the Arabs with the opportunity to select a "third path" that would reject the U.S. and Soviet spheres of influence in favor of a collaborating with a "partner which history and geography both dictate to be their natural one."[28]

The Euro-Arab dialogue, however, never really got off the ground. The British Foreign Office feared that there existed "an obvious danger that the dialogue could degenerate into muddle."[29] This worry proved prescient. Disagreement about whether Palestine should participate hindered progress (France was the lone European country to accept Palestinian participation).[30] When the two sides finally established working groups in June 1975 – more than a year after the dialogue formally launched – they focused on technical topics such as agricultural development. Discussion of the major issue in European-Arab relations – the supply of oil and its price – did not take place in this forum; the inclusion of non-oil producing members of the Arab world and the exclusion of major consumers such as the United States and Japan meant that they could not come to any meaningful agreements about oil. The French had envisioned the Euro-Arab dialogue as a forum to establish closer relations between the two

[26] Hart, *The New International Economic Order*, 120.
[27] "Memorandum of Conversation," June 5, 1974, NARA, RG 59, Records of Henry Kissinger, 1973-77, Nodis Memcons June 1974, Box 8.
[28] "First Meeting of the Steering Group on the Euro/Arab Dialogue," undated (likely summer 1974), UKNA, FCO 96/157.
[29] "Record of Meeting of the Steering Group on the Euro-Arab Dialogue," July 16, 1974, UKNA, FCO 96/157.
[30] On this issue, see Ahmad Sidqi Al-Dajani, "The PLO and the Euro-Arab Dialogue," *Journal of Palestine Studies* vol. 9, no. 3 (1980): 180-98. On European policy, see "Vortragender Legationsrat I. Klasse von der Gablenz, z.Z. Dublin, an das Auswärtige Amt, 14. Februar 1975," *Akten zur Auswärtigen Politik der Bundesrepublik Deutschland* (AAPD) 1975, Bd. 1, doc. 27.

regions and provide Paris an opportunity to take a leadership role in European foreign policy, but the dialogue fizzled and ultimately ended with the Camp David Accords in early 1979.[31]

Giscard's proposal in October 1974 for a larger conference consisting of the industrial democracies, oil-producing countries, and developing states had greater success. Building on an earlier initiative of Saudi Arabian Oil Minister Ahmed Zaki Yamani, Giscard suggested a multilateral conference in early 1975 to deal with a range of economic and financial questions.[32] With an inflation rate of 14 percent, climbing unemployment numbers, and a 65 percent dependency on Arab oil, Paris was eager to come to terms with the producers on energy and related financial issues.[33] In addition to the economic benefits that the conference would yield, Paris also undoubtedly expected that its prestige in the developing world would rise as a result of its leadership role. The British Foreign Office characterized Giscard as wanting "to show himself as active on the world stage, not as de Gaulle did by histrionics, but by initiatives for cooperation."[34]

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[31] Robert J. Lieber, *The Oil Decade: Conflict and Cooperation in the West* (New York: Praeger Publishers, 1983, 65-66. On the causes of the failure of the dialogue, see Rory Miller, "The Euro-Arab Dialogue and the Limits of European External Intervention in the Middle East, 1974-77," *Middle Eastern Studies* vol. 50, no. 6, (2014): 936-59.

[32] On the producer side, there also existed disagreement about the desirability of a consumer-producer meeting. It became clear at the Sixth Special Session of the UN General Assembly in April 1974 that some oil producers sought to delay meeting with the industrialized nations. Some such as Algeria were "positively against it." They later developed two variants of a conference. First, the Shah fancied a large multilateral meeting of just the members of OPEC and the OECD. The Iranians wanted to discuss only oil at the conference and index it somehow to the rate of inflation to protect producer profits. Second, Sheikh Yamani suggested at the Sixth Special Session that there should be a tripartite meeting of producers, industrialized countries, and LDCs. Importantly, the Saudis wanted to address a range of major commodities, including the indexation of oil to a basket of other prices (particularly manufactured goods), reform of the international monetary system, programs for industrialization of the producer countries, transfers of technology, and the regulation of multinational (especially oil) companies. Energy Department, "Brief for UK Delegation to the Standing Group of the IEA: Consumer-Producer Relations," December 3, 1975, UKNA, FCO 59/28.

[33] Referat 403, "Vorschlag des französischen Staatspräsidenten zur Einberufung einer Konferenz der industrialisierten Verbraucherländer, der Entwicklungsländer und der Erdölexportländer," November 6, 1974, PA-AA, B 71 (ZA), Bd. 113909.

[34] Nicholas Henderson to London, "French Assessment of Results of the North South Conference and Reasons for Particular Initiatives by President Giscard," December 30, 1975, UKNA, FCO 59/1385.

France's European allies generally approved of the proposal. They also feared the ramifications of another oil crisis and believed that uninterrupted access to Middle Eastern oil required a multilateral conference. The West German Foreign Office, for example, "believe[d] that the achievement of our goal to cooperate with the producer countries demands a quick establishment of a multilateral dialogue." In the economic realm, Bonn believed that the conference could lead to the "stabilization of our oil supply."[35] From a political perspective, the West German Foreign Office hoped that coming to terms with the oil producers would also "be in the interest of peace" in the Middle East, reducing the potential of the redeployment of the oil weapon. On the consumer side, a successful conference could also lead to a *rapprochement* between the United States and France, "ensur[ing] that no energy-related conflict would break out between the two."[36] For the West Germans as well as other Western Europeans – who sought to strike a balance between alliances with Paris and Washington – this would make their lives much easier.

The dialogue did not have an auspicious start. The participants convened a "preconference" in April 1975 to set an agenda for the formal meeting, but the developed and developing worlds accomplished very little. The positions taken at the preconference were somewhat predictable: while the industrial countries pressed for agreements on energy and related issues, the developing world sought to turn the conference into a wide-ranging discussion of the NIEO that would culminate in settlements about non-oil commodities, development aid,

[35] Referat 403/412, "Konferenz der erdölverbrauchenden und der erdölexportierenden Länder: Vorkonferenz und damit verbundene Fragen der EG-Energiepolitik," January 27, 1975, PA-AA, B 71 (ZA), Bd. 113909.
[36] Referat 403, "Beitrag des Auswärtigen Amtes zur Aufzeichnung für den Bundeskanzler über die wirtschafts-, finanz-, und außenpolitischen Ziele, die die Bundesrepublik Deutschland auf der Konferenz mit den Produzentenländern und anderen Verbraucherländern anstrebt: Aussenpolitische Ziele," March 11, 1975, PA-AA, B 71 (ZA), Bd. 113909.

and debt relief. The West German embassy in Paris reported that the conference only bred mistrust between the two sides.[37]

A particularly contentious issue that emerged was the proposal that oil prices should be linked to a basket of manufactured goods' prices. This became known as "indexation." Above all, the oil countries worried about the purchasing power of their earnings from their exports, fearing that the rampant inflation in the West would diminish the value of their surpluses. The Shah of Iran Mohammad Reza Pahlavi complained to Ford and Kissinger that prices had risen 35 percent. The solution, the Shah emphasized, lay in "some tangible predictable relationship" between raw materials and manufactured goods. "We must index the prices," he told the Americans.[38] Indexation also offered the chance to strengthen the political unity of OPEC by ensuring that its members would not break the cartel to pursue bilateral agreements. Indexation portended to spread from oil to other valuable raw materials such as nonferrous metals, allowing non-oil producing states to capitalize on their resources as well.[39]

The developed countries generally rejected that idea. They believed that indexing the price of oil to manufactured goods would make high oil prices a permanent feature of the international economy. Policymakers in the industrial states with weak economic positions such as Britain and France, however, reluctantly recognized that they could use indexation as a bargaining tool with OPEC.[40] Harold Lever, for example, doubted Simon's conviction that the market would rectify the high prices and believed that the consumers needed to engage in dialogue with the producers. As a *quid quo pro* for lower prices, he thought that the consumers should offer to link the prices of a basket of manufactured goods to oil. Lever stressed that

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[37] "Aufzeichnung des Botschafter z.b. V. Robert," April 18, 1975, AAPD 1975, Bd. 1, doc. 87.
[38] "Memorandum of Conversation," May 16, 1975, GFPL, NSA, Memoranda of Conversations, 1973-1977, Box 11.
[39] Hans Friderichs, "Indexierung der Ölpreise," May 20, 1975, BAK, B 136/9357.
[40] Garavini, *After Empires*, 199.

cutting consumption would not solve the problem – OPEC would simply decrease production to match. Healey was not opposed to the idea, but other economic advisers such as Secretary of Trade Peter Shore viewed indexation with skepticism. They thought that the more prudent way to reduce prices was to play on the differences among oil producers and the common interest of ensuring that the economies of the industrial democracies did not collapse.[41] Countries with better balance-of-payments positions did not even entertain the idea; Washington and Bonn agreed that "indexation is out of the question."[42]

The main Conference on International Economic Cooperation (CIEC) took place in December 1975 in Paris under the chairmanship of Giscard.[43] The first round of talks established four commissions: energy, commodities, development, and finance. Each commission would have co-chairmen – one each from the developed and developing worlds.[44] The opening of this dialogue represented a symbolic victory for Paris, which had been pushing for such a conference for over a year. As Garavini argues, the opening of the CIEC also offered the Group of 77 the chance to exploit the oil weapon to realize objectives in a range of areas.[45] U.S. National Security Advisor Brent Scowcroft reported that "there are widespread doubts as to whether the Commissions will achieve anything of substantive significance," but the United States still ran "major risks." He warned that the Europeans and Japanese might prove amenable to the developing world's demands because of their dependence on imports, and rising tensions could

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[41] "Record of a Meeting in the Foreign and Commonwealth Office," December 6, 1974, UKNA, FCO 59/1171.
[42] Hans Friderichs to Henry Kissinger, July 23, 1975, BAK, B 102/193194.
[43] The countries that participated in the CIEC included: Australia, the European Community, Japan, Canada, Sweden, Switzerland, the United States, Spain, Egypt, Algeria, Argentina, Brazil, India, Indonesia, Iraq, Iran, Jamaica, Yugoslavia, Mexico, Nigeria, Pakistan, Peru, Zambia, Saudi Arabia, Venezuela, Zaire, and Cameroon.
[44] For a copy of the final communique of the conference, see "Final Communique," December 19, 1975, NARA, RG 56, Office of the Under Secretary for Monetary Affairs, Records of Assistant Secretary for Trade, Energy, and Financial Resources, Policy Coordination Gerald L. Parsky, Energy: Meetings, Box 2. This document committed the members "to initiate an intensified international dialogue" to discuss energy, raw materials, development, and financial affairs.
[45] Garavini, *After Empires*, 222.

create "an adverse climate for US investment in the Third World" as well as less reliable raw material supplies. [46]

By the time of the final session of the CIEC in the late spring of 1977, the North-South dialogue had ended in stalemate. Former Foreign Minister of Guyana and Secretary-General of the Commonwealth of Nations Shridath Ramphal lamented in late 1977 that there existed a "failure of the CIEC to agree even on the character of its disagreement."[47]

Why did the North-South dialogue not live up to the developing world's expectations?[48] First, U.S. and West German adherence to free-market principles made them unwilling to engage in dialogue with the developing world on issues that would redress the balance of power in the global economy. They made minor allowances to the developing world – including various agreements to increase aid – but the industrial democracies thwarted the NIEO's objective of reconstructing the international system run through the United Nations.[49] Other scholars have emphasized the American role, but West German opposition was also decisive.[50] Bonn exercised tremendous power within the European Community and its opposition to indexation, the financing of raw materials through the IMF, and the creation of SDRs to meet global demand denied gave Europe a strong voice against acquiescing to some of the global South's demands.[51] Vehement West German resistance ensured that the more sympathetic French, Dutch, and Belgians could not consolidate a common European position against the United States.

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[46] "Memorandum From the President's Assistant for National Security Affairs (Scowcroft) to President Ford," undated, FRUS, 1969-1976, vol. 31, doc. 300.
[47] "Statement by Shridath S. Ramphal at the opening session of the Independent Commission on International Development Issues, Gymnich Castle," December 9, 1977, Archiv der sozialen Demokratie der Friedrich-Ebert Stiftung, Bonn, Germany, Willy Brandt Archiv, A14/9.
[48] N.P. Bayne, "Meeting of FCO Ministers on the North/South Dialogue," October 24, 1979, UKNA, FCO 59/1680.
[49] On Kissinger's strategy to use food aid as a mollifying tactic, see Sargent, *A Superpower Transformed*, 179-82.
[50] See, for example, Mazower, *Governing the World*, 315.
[51] Referat VII A 3, "Wünsche der Entwicklungsländer und deutsche Position gegenüber diesen Wünschen," December 8, 1975, BAK, B 136/9304

Second, the alliance between oil-producing and non-oil-producing members of the global South failed to hold. The developing countries had pressed demands for greater opportunity in the global economy for two decades, but the industrial democracies only came to the negotiating table in the mid 1970s because of the oil crisis; without OPEC's success in 1973, the global South likely would have received only vague platitudes from the industrial democracies. The West believed that there was a link between participation in the North-South dialogue and negotiations on oil prices. Algeria and Libya supported the NIEO and sought a radical transformation of the relationship between North and South, but the more conservative members did not want to participate in the crusade. These producers – including Saudi Arabia and Iran – needed to retain good political and military relations with the West and aimed to maximize receipts from their oil reserves. The non-oil producing developing countries suffered from the oil crisis even more than the developed countries, but the producers did not want to sacrifice their profits in order to cushion the blow for the rest of the global South. Yamani admitted, "If oil is the issue, then we can't hide our view – we talk as OPEC."[52] The industrial democracies recognized these divisions and sought to exploit them.[53]

The failure of the NIEO took a significant toll on the global South. The non-oil producing developing countries were among the hardest hit by the oil crisis, and the people in those countries suffered. The Ethiopian ambassador to the United States Kifle Wodajo reported that the "greatly increased prices of oil and fertilizer" precipitated serious dislocations in Ethiopia. In the Chilean military regime, Pinochet dealt with its oil deficits by imposing austerity on his people,

[52] "Memorandum of Conversation," March 19, 1975, NARA, RG 59, Records of Henry Kissinger, Nodis Memcons, March 1975, Folder 6, Box 10.

[53] As early as the 6th Special Assembly of the U.N., for example, the West German Foreign Office pointed to the extraordinary act of unity among the developing world in issuing the NIEO, but repeatedly questioned whether this unity would hold once they reached the negotiating table. See Referat 400, 402, "Sachstand: 6. Sonder-Generalversammlung der Vereinten Nationen über Rohstoffe und Entwicklung vom 9. April – 2. Mai 1974," May 24, 1974, PA-AA, B 54 (ZA), Bd. 1222010.

calling it the "year of sacrifice"–which was then extended by another twelve months. Inflation and poverty led to huge political demonstrations against the Indian Prime Minister Gandhi, who had to declare a state of emergency and suspend democratic institutions in June 1975. Oil profits kept rolling in for OPEC and the West avoided a structural transformation of the international economic system, but the people in the global South bore a heavy burden.[54]

The deficits of the LDCs also loomed as a destabilizing issue in the international economy. Because of the weak position the LDC economies, they were the group of countries hardest hit by the oil crisis. Non-oil producing members of the developing world such as India depended on OPEC for their oil just as much as the developed world did.[55] The LDCs faced the same problem as the industrial democracies but had far fewer resources to pay for oil imports. The OECD estimated that the terms of trade for the non-oil producing countries should improve by roughly ten percent because of the spike in the cost of other commodities, but the energy crisis would "wipe out" this gain.[56] The hardest-hit LDCs were among the poorest nations in the world; countries such as Bangladesh, Botswana, Guyana, Senegal, Niger, and Vietnam had no valuable exportable commodity to soften the blow.[57] The current account deficits of the non-oil producing LDCs rose from $4.8 billion in 1973 to $28.8 billion in 1974 and $38.5 billion in 1975.[58]

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[54] Christopher R.W. Dietrich, *Oil Revolution: Anticolonial Elites, Sovereign Rights, and the Economic Culture of Decolonization* (Cambridge: Cambridge University Press, 2017), 296-97.
[55] Mark Atwood Lawrence, "The Rise and Fall of Nonalignment," in *The Cold War in the Third World*, ed. by Robert J. McMahon (New York: Oxford University Press, 2013), 152.
[56] Development Assistance Directorate, "Preliminary Assessment of the Implications of Recent Oil Price Increases for Development Cooperation," January 28, 1974, OECD Archive, DD-376. On this issue, see also Hans Friderichs an das Auswärtige Amt (Referat 402), "Unmittelbare und mittelbare wirtschaftliche Auswirkungen der Energiekrise auf die Entwicklungsländer," November 30, 1973, PA-AA, B 54 (ZA), Bd. 122128.
[57] Diane Kunz, *Butter and Guns: America's Cold War Economic Diplomacy* (New York: The Free Press, 1997), 262. Some of these countries such as Bangladesh did not experience a large increase in their oil bills because their level of modernization and industrialization was low. The increase in the oil cost, however, still imposed a serious burden because they had a low level of income.
[58] James, *International Monetary Cooperation Since Bretton Woods*, 257.

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The second battle came in finance and international monetary policy. The exploding oil prices affected far more than just the energy industry. One of the major byproducts of the oil crisis was the financial effect of the enormous transfer of capital from the industrialized world to OPEC. In January 1974, oil expert Walter J. Levy noted, “The world oil crisis has suddenly been transformed from a critical <u>oil supply</u> problem to a severe, world-wide <u>financial</u> problem.”[59] The magnitude of the sums involved, the Committee on Financial Markets of the OECD summarized in February 1974, “represents the biggest re-adjustment problem in world trade and payments since the last war.”[60] The producers ran a surplus of about $60 billion in 1974, and nobody knew how high this figure would climb; a World Bank report speculated that OPEC’s accumulated reserves could reach $650 billion by 1980 and soar to $1.2 trillion by 1985, a sum roughly equivalent to the GDP of the U.S. in 1973.[61] An ad hoc group of the Energy Coordinating Group to analyze the future of the international oil market admitted that “we have no experience with changes even approaching the magnitude of those in the recent past.”[62] This new financial power could become yet another economic weapon at OPEC’s disposal. If the producers decided to withdraw their money from financial markets, it would have a massively destabilizing effect on the Western banking system. The fact that no lender of last resort existed to insure the financial markets meant that there was no protection for defaults or bank failures, events that could trigger

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[59] Walter J. Levy Consultants, “Implications of Exploding World Oil Costs,” January 1974, UKNA, FCO 59/1164. Phrases underlined in the original.
[60] Committee on Financial Markets, “Repercussions of the Oil Price Increase on National and International Financial Markets,” February 8, 1974, Organization for Economic Cooperation and Development (OECD) Archive, Paris, France, CMF(74)3.
[61] Terry Robards, “Spending the Oil Money: Producing Nations Have an Embarrassment of Petrodollars,” August 4, 1974, *New York Times*, p. 154. This represented about three percent of the GNP in Western Europe and Japan.
[62] ECG report 32, “Report of Ad Hoc Group on International Oil Market,” May 2, 1974, NNA, 2.05.313, 17519.

a domino effect and cripple the whole system.[63] During an era of fluidity in international finance and following the collapse of two of the world's largest banks – Franklin National (U.S.) and Herstatt (West Germany) – in 1974, capital markets were uneasy and interbank lending fell.[64]

How should the international community handle the new surpluses and channel the funds in a way that would provide stability for the industrial democracies and not cripple the non-producing LDCs? The British Foreign Office observed, "We must accept of course that they will not either keep it under the bed or be able to invest more than a very small proportion in development in the Arab world."[65] The options were to channel the funds through international institutions, or leave it to the market. Here the battle lines were drawn between the IMF, and the U.S. and West Germans. The IMF sought to facilitate an institutional solution to the oil deficits. In early January 1974, IMF Director Johan Witteveen proposed the creation of a special temporary facility to help countries that struggled to finance the increases in oil prices. After OPEC's announcement on December 23 that it would increase prices even further, Witteveen feared that the world – particularly the LDCs – could not cope with the subsequent current account deficits. He believed that the IMF should provide accessible loans to oil-importing LDCs with lax terms to cushion the burden.[66] Washington and Bonn opposed the project because they feared that it would give legitimacy to OPEC's high prices and surpluses, but the oil facility

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[63] The FCO also remarked, however, that the central banks collectively could pool their resources to ensure that a major bank would not collapse. Steering Brief, Annex B, "The State of the Euro-markets," July 4, 1974, UKNA, PREM 16/290. The West German Kanzleramt downplayed the possibility of a purposeful Arab attempt to destroy the Western financial system, but warned that the Arabs could refuse to invest their petrodollars in countries that had friendly relations with Israel. See Gruppenleiter IV/2, "Maßnahmen gegen eventuelle wirtschaftliche und monetäre Repressionen durch die Araber," February 20, 1975, BAK, B 136/9302.
[64] Kissinger also feared that Arab revenues posed a threat to stability in the Middle East; the producers used some of their surpluses to purchase arms from the Soviet Union and weapons flowed into the region, increasing Soviet influence in the region and the Arab competitive position vis-à-vis Israel. "Memorandum of Conversation," September 28, 1974, FRUS, 1969-1976, vol. 37, doc. 9.
[65] A.D. Parsons, "Oil as a Weapon in the Arab-Israeli Conflict," February 7, 1973, UKNA, FCO 93/296.
[66] Margaret Garritsen de Vries, *The International Monetary Fund 1972-1978, Volume 1: Narrative and Analysis* (Washington, D.C.: International Monetary Fund, 1985), 312.

found support from Japan and the rest of the European Community. The IMF established the oil facility in September 1974, and countries had access to it based on a formula that calculated requisite oil imports and the overall balance of payments. Thirty-three developing countries, six developed oil-producing countries, and Italy borrowed from the oil facility. Witteveen proposed the establishment of a second oil facility in June 1975, designed to include more lending to the industrial countries – Britain and Italy took advantage.[67]

As a result, investment of their profits in the Western financial system promised the best solution for OPEC. This process became known as "recycling."[68] International pressure grew during 1974 and 1975 for multilateral solutions to recycling. OECD Secretary General Emile van Lennep, for example, worried that the free market could not handle the massive surpluses. "We just cannot assume that private market arrangements can efficiently cope both with absorbing the surpluses and with directing them where they are needed," he said.[69] The OECD cautioned against the industrial democracies taking competitive measures to correct their deficits by increasing exports, and instead stressed that the member states take a cooperative position to ensure that each country "can get a fair access to the external funds it needs."[70] It created a $25 billion facility to help members that struggled to make energy payments.[71] London agreed with the OECD's analysis and pushed for a "systematic re-allocation of the surpluses." Levy noted to his colleagues that the "recycling of the surpluses was being dealt with in an ad hoc, not to say

[67] James, *International Monetary Cooperation Since Bretton Woods*, 31-18. James contends that the establishment of the IMF's two oil facilities changed the character of the organization by moving the IMF closer to functioning like a bank.
[68] See David E. Spiro, *The Hidden Hand of American Hegemony: Petrodollar Recycling and International Markets* (Ithaca, NY: Cornell University Press, 1999).
[69] Christopher R.W. Dietrich, "The Permanence of Power: Postcolonial Sovereignty, the Energy Crisis, and the Rise of American Neoliberal Diplomacy, 1967-1976" (PhD dissertation, University of Texas at Austin, 2012), 297.
[70] Committee on Financial Markets, "Repercussions of the Oil Price Increase on National and International Financial Markets," February 8, 1974, OECD Archive, CMF(74)3.
[71] Referat 403, "Konferenz der erdölverbrauchenden und der erdölerzeugenden Länder," February 8, 1975, PA-AA, B 71 (ZA), Bd. 113909.

anarchic, way."[72] In particular, the British worried that the United States would receive the lion's share of the money and the other industrial democracies would struggle to finance their debts.[73] Harold Lever, for example, wanted to enact a scheme whereby the producers would only be able to invest about $10 billion of their massive surpluses in the free market; "all the rest would be isolated from the world's ordinary monetary system and be stored in an international fund."[74] The British pushed for expanded roles for the IMF, OECD, and other multilateral institutions that could distribute funds where they were needed most.

The United States and West Germany strongly opposed this plan and advocated the market as the primary means for recycling. In the case of Washington, Christopher Dietrich argues that U.S. policymakers feared that a multilateral approach would legitimize high prices and "put OPEC in the driving seat."[75] They also, however, believed that funneling petrodollars into U.S. private and public accounts offered a number of advantages for Washington. Investment in the United States bred interdependence between the United States and the Arab world, giving the members of OPEC a stake in U.S. economic success. "We've got to come up with ways to soak up their dough," Kissinger said. "Our principal objective should be to maximize their dependence on us."[76] OPEC investment linked the economies of the two regions, giving the "Bedouins" – in Kissinger's words – a disincentive to pursue policies that would disrupt the smooth functioning of the U.S. economy (i.e., the redeployment of the oil weapon).

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[72] "Record of a Meeting in the Foreign and Commonwealth Office," December 6, 1974, UKNA, FCO 59/1171. "Ad hoc" underlined in the document.
[73] F. Lisle Widman, "Investment of Oil Exporter Surpluses in U.S." (Draft), October 30, 1974, NARA, OASIA, Chronological Files of Deputy Assistant Secretary for International Monetary Affairs F. Lisle Widman, 1967-1978, F.L. Widman Chron October, Box 7.
[74] Harold Lever to Harold Wilson, "The Oil Money Problem," November 1, 1974, UKNA, FCO 49/553.
[75] Dietrich, "The Permanence of Power," 303.
[76] "Memorandum of Conversation," February 3, 1975, *FRUS, 1969-1976, vol. 37*, doc. 39

Petrodollars also financed U.S. debts, constituted long-term investment in the private sector, and facilitated purchases of military equipment.[77]

The elimination of capital controls such as the Kennedy-era Interest Equalization Tax facilitated the flow of OPEC surpluses to U.S. financial markets. Led by Walter Wriston of First National City Bank (later Citibank), private bankers lobbied the government to remove capital restrictions. An economist noted, "After that you could hardly find a banker at home."[78] The United States emerged as an attractive destination for petrodollars. OPEC invested about $11 billion in the U.S. financial market (about 18 percent of a total surplus of $60 billion), particularly in Treasury bills and other U.S. government securities.[79] Morgan Bank estimated that in 1974 the banking system provided financing for approximately half of the current account

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[77] David M. Wright, "The Petrodollar Era and Relations between the United States and the Middle East and North Africa, 1969-1980" (PhD dissertation, University of California at Irvine, 2014), 82. On U.S. policy toward recycling, see also William E. Simon to Gerald R. Ford, "Memorandum for the President: Recycling," Skillman Library, Simon Papers, Series IIIB, Drawer 25, Folder 36. The influx of petrodollars stimulated opposition from domestic elements within the United States, particularly from pro-Israel groups and those that feared that foreigners would come to control vital U.S. industries. Arab investors attempted and failed in 1974 to purchase a controlling share of Lockheed Aircraft Corporation, an episode that seemed to confirm fears about increasing Arab influence and ulterior motives. Cartoonish depictions of Arab economic power bred resentment among Arab groups in the country. Likewise, donations from Arab sources to universities earmarked for the study of the Middle East met skepticism and sometimes hostility from the U.S. public. These funds supported new institutes for Arab studies at prestigious schools such as Georgetown University and the University of Southern California, and the public backlash stimulated debates about what role oil money should play in education. A similar situation unfolded when the Iranian government sought to purchase a share in Pan American World Airways in late 1974. The airline suffered from a financial crisis and Iranian investment would avoid a potential government bailout, but the symbolic importance of Pan Am complicated matters as the public was wary about having Iranian involvement in the iconic airline. On the cultural effects of petrodollars in the United States, see Salim Yaqub, *Imperfect Strangers: Americans, Arabs, and U.S.-Middle East Relations in the 1970s* (Ithaca, NY: Cornell University Press, 2016), especially 276-301. See also Kunz, *Butter and Guns*, 257.

[78] Mazower, *Governing the World*, 347.

[79] Referat 412, "Hauptprobleme der internationalen Währungslage," May 2, 1975, BAK, B 136/9302; Treasury paper, "The Financial and Economic Consequences of the Quadrupling of the Price of Oil," September 26, 1974, NARA, RG 56, OASIA, Chronological Files of Deputy Assistant Secretary for International Monetary Affairs F. Lisle Widman, 1967-1978, F.L. Widman Chron September, Box 7.

deficits of the consumers.[80] The Treasury believed that deficits were acceptable as long as the United States could attract capital.[81]

Schmidt embraced the U.S. strategy of attracting petrodollars to the financial markets. Concern about domestic stability motivated him. Schmidt feared that inflationary effects on the prices of manufactured goods that the oil crisis had caused would slow the rise of living standards. If his government did not take measures to eliminate the balance of payments deficits, he worried that unemployment would rise. This would lead to social upheaval in West Germany, a phenomenon that had already had disastrous consequences for his country: "High levels of unemployment, roughly 7 million people in 1931-32, was the reason Hitler came to power," Schmidt reminded his colleagues.[82] Petrodollars seemed to offer a solution. Schmidt eliminated the capital controls of 1972 and 1973 that had been put in place to stem the tide of hot money rushing into the country; now, only a year or two later, the West German government changed course.[83] The chancellor believed that if surplus petrodollars became a permanent feature of international economics, there would be no reasonable alternative to their investment in industry and portfolios. "People would be reluctant to accept this," Schmidt told Wilson, "but there was no other way out."[84]

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[80] Eugene R. Black, Jr. to Jack F. Bennett, March 21, 1975, Skillman Library, Simon Papers, Series IIIB, Drawer 25, Folder 36.
[81] Treasury paper, "WP-3 Meeting Talking Points: Balance of Payments Adjustment," May 25, 1977, NARA, RG 56, OASIA, Chronological Files of Deputy Assistant Secretary for International Monetary Affairs F. Lisle Widman, 1967-1978, Widman, Chron May 1977, Box 9.
[82] "Memorandum of Conversation," June 27, 1976, FRUS, 1969-1977, vol. 31, doc. 148.
[83] The controls had been put in place by the Brandt government in an effort to slow the flood of hot money rushing into the country during the collapse of Bretton Woods. These included a "cash deposit" law and a stipulation that West German businesses needed to obtain a permit before using foreign funds in their businesses. Gray, "Learning to Recycle," 177-80.
[84] "Record of a Conversation between the Prime Minister and Federal German Chancellor at 11.00 a.m. in the Palais Schaumburg in Bonn on Wednesday 19 June 1974," UKNA, PREM 16/99. Furthermore, Emminger noted that fears that OPEC would place their funds in a way that disrupted the industrial democracies' ability to finance their debts proved unfounded. "The Monetary Consequences of the Oil Price Explosion and its Implications for the Euro-currency Markets: Address by Otmar Emminger, Deputy Governor of the Deutsche Bundesbank, at the Bank of Spain, Madrid," October 14, 1974, PA-AA, B 52 (ZA), Bd. 117102.

Petrodollars embodied the new age of economic globalization–and a neoliberal triumph. The process of recycling through financial markets represented a neoliberal triumph over multilateral institutions and contributed to what Hal Brands terms "a veritable explosion" of global capitalism. World trade tripled between 1973 and 1979, and the value of international financial markets rose from $160 billion in 1973 to $3 trillion in 1985. This was one unanticipated benefit of the oil crisis – recycling empowered Western economies with a seemingly unending supply of foreign capital. While the ability of the industrial democracies to absorb petrodollars accelerated economic growth, the inability of the LDCs to do so meant that they had to seek loans from Western banks and financial institutions that were now flush with cash. This became a point of leverage for the West and a second unanticipated consequence: as the LDCs became more dependent on the goodwill of their Western creditors, the power of the NIEO weakened.[85]

Petrodollars linked the oil crisis to the broader question of the future shape of the international monetary system. In the early 1970s, policymakers had implemented capital controls in an effort to protect the old order, but the removal of capital controls to accommodate cross-border petrodollar flows pushed the industrial democracies further away from the fixed system of Bretton Woods. The collapse of Bretton Woods in March 1973 and the turn toward what Harold James has called a "non-system" of flexible exchange rates left the international monetary system in flux in the mid 1970s.[86] Most Western Europeans envisioned a gradual return to a system of fixed but adjustable par values.

France pushed this plan most strongly. In fact, Paris went further than Bretton Woods by suggesting that floating could only be authorized by the IMF alone. Giscard believed that

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[85] Brands, *Making the Unipolar Moment*, 56-66.
[86] James, *International Monetary Cooperation Since Bretton Woods*, 258.

floating exchange rates were "fundamentally bad because they remove certain constraints on governments to pursue anti-inflationary policies."[87] Paris also believed that fixed exchange rates would also keep the French economy anti-inflationary to keep pace with the West Germans. The French proposal sought to reestablish "order" amidst the "state of confusion we are nowadays facing."[88] By imposing discipline, the French hoped to limit inflation. Giscard believed that floating exchange rates and the uncertainty associated with them contributed to the instability in the oil and commodities markets, placing upward pressure on prices. Because France depended on oil imports – far more than the United States or even Britain – and it was particularly sensitive to price increases, particularly after the depreciation of the dollar in 1974 and 1975 that gave U.S. exports a competitive advantage.

In early July 1975 during an interview with *Hearst*, Giscard floated the idea of a summit among the heads of state of the industrial democracies to discuss the international monetary system and the world economic outlook. He saw an economic summit as a means of ensuring that Washington – as it had done with "benign neglect" – did not make policy little regard for how it affected the rest of the world.[89] Thus, the French push for a return to Bretton Woods stemmed from their desire to stabilize the global economy and improve the French balance of payments position, a critical task in the face of domestic communist opposition.

Paris' backwards-looking proposal about a gradual return to Bretton Woods, however, misinterpreted the changing contours of the global economy. It failed to reconcile French short-term goals with the structural changes in the economy that had long-term implications. With the

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[87] N.P. Bayne to C.W. Fogarty, "Giscard's Proposal for a Monetary Conference," August 20, 1975, UKNA, FCO 59/1365.
[88] Ministère de l'économie et des finances, "Scheme of a Gradual Return to a System of Stable but Adjustable Par Values," undated (but likely July or August 1975), BAK, B 136/9304.
[89] Referat 412, "Giscard's Idee einer internationalen Wirtschafts-und Währungskonferenz," July 11, 1975, PA-AA, B 202 (ZA), Bd. 105679.

introduction of highly-mobile capital and inflationary pressure on prices, fixed exchange rates had become an anachronism. The French proposal found little support. Bonn, for example, pointed out that in an age of high oil prices, fixed exchange rates would be very risky. Climbing energy costs placed upward pressure on prices, and inflation's destabilizing effect on the international monetary system portended a repeat of the collapse of Bretton Woods.[90] The West Germans agreed that a return to a fixed exchange rate system was desirable in principle, but doubted whether it was advisable in the current climate.[91] Predictably, U.S. policymakers–particularly in the Treasury–viewed a return to Bretton Woods with suspicion. The return of fixed exchange rates, Simon feared, would the continuous uncertainty and speculative assaults on currencies that had plagued the international monetary system in the late 1960s and early 1970s.[92]

In addition to the misgivings about French monetary policy, the major industrial democracies did not all greet Giscard's proposal for an economic summit with enthusiasm. Over the next four decades, economic summitry among the major industrial democracies would become a critical forum for discussion among the heads of state about economic issues ranging from monetary policy to energy, but the birth of what would become known as the Group of 7 (G7) did not emerge as a result of intelligent design. On the contrary, the industrial democracies stumbled onto the concept; the formation of the G7 should not be seen, as others have argued, as the culmination of a linear process that began in 1973.[93] In the United States, Simon pressed

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[90] Referat VII A 3, "Französischer Stufenplan für Rückkehr zu festen Wechselkursen," August 21, 1975, BAK, B 136/9304.
[91] Referat VII A 3, "Wechselkursbestimmungen des IWF," September 11, 1975, BAK, B 136/9304.
[92] William E. Simon to Gerald R. Ford, July 26, 1975, FRUS, 1969-1976, vol. 31, doc. 93.
[93] The personalized approach to international economy policy emerged in March 1973 with the inauguration of the "Library Group," an informal meeting among the high-ranking economic officials of the major industrial democracies. Helmut Schmidt in particular emerged as a proponent of this type of personal diplomacy. Giuliano Garavini argues, for example, that the "creation of the G7 was a direct response to the battle waged by the Global South to promote a new international economic order" and had roots in the "Library Group" of formed at the

Ford to reject the idea, believing that it would only serve as a forum for Giscard to continue his "campaign" for a restoration of the pre-August 1971 conditions in the international monetary system.[94] The British Treasury shared Simon's concerns, characterizing Giscard's initiative as an attempt to move the monetary policy negotiations away from financial experts and into the hands of the less-knowledgeable and more politically-minded heads of state.[95]

The meetings took place from November 15-17, 1975 at the Château de Rambouillet, located 30 miles southwest of Paris.[96] The heads of state emphasized the importance of collaboration on issues of economic interdependence, and officials noted the inescapable reality that global economic performance was tied to social and economic stability at home. The three sessions of the conference, Sargent describes, began "with a gush of hortatory language."[97] When it came to substance, however, there existed tension between U.S. policymakers and their European counterparts on the extent to which the state should intervene in the global economy. This ideological disagreement shaped each of the sessions. During the first session, for example, Wilson called for a collaborative "Marshall Plan type initiative, especially for the Third World," while Ford instead stressed "the goal of an open world economy."[98] The next day on monetary

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beginning of 1973. In contrast, this chapter comports with the recent argument of Elizabeth Benning, who argues that the West Germans managed to coopt a narrow French proposal to reform the monetary system into a more comprehensive analysis of the economic problems facing the industrial democracies as a group. See Benning, "The Road to Rambouillet and the Creation of the Group of Five," in *International Summitry and Global Governance: The Rise of the G7 and the European Council, 1974-1991*, ed. by Emmanuel Mourlon-Druol and Federico Romero (New York and London: Routledge, 2014), 39-63.

[94] William E. Simon to Gerald R. Ford, "Possible Conversation with the President of France on Economic Matters," July 26, 1975, NARA, RG 56, OASIA, Chronological Files of Deputy Assistant Secretary for International Monetary Affairs F. Lisle Widman, 1967-1978, F.L. Widman Chron July 1975, Box 8.

[95] Charles A. Cooper to Simon, "Status of French Proposals for an Economic Summit," July 21, 1975, NARA, RG 56, OASIA, Chronological Files of Deputy Assistant Secretary for International Monetary Affairs F. Lisle Widman, 1967-1978, F.L. Widman Chron July 1975, Box 8.

[96] Edward Tomkins to James Callaghan, November 25, 1976, UKNA, PREM 16/838. Heads of state enjoyed lavish accommodation, but their entourages found it uncomfortable. The French chose the château to give the meetings "a house-party atmosphere," but its small size cramped the officials. The British delegation, for example, conducted its preparations in Napoleon's bathroom, and French Foreign Minister Jean Sauvagnargues worked at a table in a corridor.

[97] Sargent, *A Superpower Transformed*, 192.

[98] "Memorandum of Conversation," November 15, 1975, FRUS, 1969-1976, vol. 31, doc. 122.

matters, Giscard pushed "to bring order to the international monetary system" and develop a mechanism to limit the fluctuation between the dollar and the Snake. Ford agreed about the desirability of a stable system, but countered the French president by reminding him that "no regime that runs counter to market realities could remain in effect for very long."[99] The summit served a psychological purpose of showing the commitment of the industrial democracies to work together to solve common problems, but the willingness to engage in dialogue did not change the fact that they had very different philosophies about how to tackle those problems.[100]

Although the summit had evolved into a broad discussion of a complex array of economic issues, the initial proposal for the summit had come from French concerns in the monetary field, and it was in this area that the single substantive agreement came. U.S. and French financial experts agreed to modify Article IV of the IMF Articles of Agreement to allow floating exchange rates. Giscard abandoned hopes for a return to fixed parities and settled for a pragmatic agreement about the relationship of the dollar to the Snake currencies. The agreement at Rambouillet set the foundation for a reform of the international monetary system. Under the chairmanship of Belgian Finance Minister Willy de Clercq, the IMF Interim Committee convened in Jamaica during January 1976 to modify the IMF Articles of Agreement so that floating exchange rates would be permitted.

The United States and West Germany won this round as well. The compromise clearly favored the United States: floating exchange rates were legitimized, the IMF abolished the

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[99] "Memorandum of Conversation," November 16, 1975, FRUS, 1969-1976, vol. 31, doc. 123. In his introductory remarks about monetary policy, Giscard noted that the turn to floating currencies was not a collective choice, but one that emerged after a series of individual decisions. He said that the main proponent of allowing the market to determine exchange rates was Karl Schiller, "who has since disappeared from the scene." Schmidt, who had succeeded Schiller as Minister of Economics in summer 1972, quipped "Thank God!"

[100] Japanese Prime Minister Miki played a notably small role in the conversations. After taking his turn to introduce the topic of international trade, Miki did not actively participate in the discussions. Kissinger wrote in his memoirs that Miki "seemed to be dozing through most of the presentations." Simon passed a note to Kissinger during the proceedings that read, "I think Miki has just died." Kissinger, *Years of Renewal*, 695.

official price of gold and its use in official transactions, the U.S. quota within the IMF increased, and Washington retained "the power to block important decisions in the IMF if not consistent with our interests."[101] The *Washington Post* reported that Simon emerged as the "big winner in the international monetary game. Simon came back from the…meeting…with everything except the proverbial kitchen sink." A Latin American representative commented to the Americans, "You fellows got everything you wanted."[102] The Jamaica Agreement represented a victory for proponents of floating exchange rates who wanted to yield the power to determine the value of currencies to the market.[103]

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The third case was the British IMF crisis of 1976. Bloated state budgets threatened to have second-order effects on the rest of the industrial democracies, exporting inflation and creating instability in financial markets. This issue represented a much larger ideological division between neoliberalism and Keynesianism. Keynesian theory presumed that deficit spending would reduce unemployment and stimulate demand during times of economic downturn, and required circumscription of the national economy from the larger global context. Increasing global interdependence, however, meant that deficit spending could have an inflationary effect abroad.[104] As a result, Washington and Bonn began using the IMF as a vehicle to compel countries to liberalize and deconstruct the welfare state.

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[101] William E. Simon, "Memorandum for the President: Jamaica Meetings of Interim and Development Committees," January 13, 1976, GFPL, NSA, International Economic Affairs – Presidential Subject File, Monetary Affairs, Box 5.
[102] Hobart Rowen, "U.S. Is Big Winner at IMF Talks: Economic Impact U.S. Emerges as Winner at IMF Talks," *Washington Post*, January 18, 1976, 56.
[103] The Jamaica Agreement, however, did not give the United States everything that it wanted. The continued centrality of the dollar in the international monetary system was both a strength as well as a source of vulnerability. U.S. officials had wanted to give SDRs a greater role but had to abandon this because of the need to compromise with the French. On the Jamaica Agreement's shortcomings for the United States, see Sargent, *A Superpower Transformed*, 193-94.
[104] See Moynihan, "The United States in Opposition."

The most dramatic example of this was the British IMF crisis in late 1976. The crisis turned on the conditions attached to a loan from the IMF and the extent to which the British were willing to rein in spending. For the British, harsh conditions from the IMF meant a strained, and possibly severed, relationship with organized labor, on whose support the Labour Party depended. For the U.S. and West Germans, continued bloated budgets in Britain threatened to destabilize the global economy. The crisis is rarely discussed outside of the context of British history, but the stakes of the negotiations about a loan from the IMF went far beyond Britain; it marked a watershed in the trajectory of global capitalism.[105]

In the mid 1970s, Labour politicians believed that their claim to power depended in large part on maintaining a good relationship with the Trade Unions Congress (TUC) – the major association of organized labor in Britain. Labour had lost the 1970 general election to Edward Heath and the Conservatives, a defeat many attributed to a split between the party and the unions after a series of strikes in the late 1960s. Running on a right-wing platform that aimed to liberate market forces, Heath had a contentious relationship with the unions. He sought to impose restrictions on their militancy and reduce their power, but the unions fought back, most prominently during the coal miner strike in early 1972. One union leader characterized Heath's

[105] A recent article on U.S.-U.K. relations during the Nixon and Ford administrations does not even mention the IMF crisis. R. Gerald Hughes and Thomas Robb, "Kissinger and the Diplomacy of Coercive Linkage in the 'Special Relationship' between the United States and Great Britain, 1969-1977," *Diplomatic History* vol. 37, no. 4 (2013): 861-905. The limited literature that explores the international politics of the crisis include Kathleen Burk, "The Americans, the Germans and the British: the 1976 IMF Crisis," *Twentieth Century British History*, vol. 5, no. 3 (1994): 351-69; and Mark D. Harmon, "The 1976 UK-IMF Crisis: the markets, the Americans and the IMF," *Contemporary British History*, vol. 11, no. 3, (1997): 1-17. I seek to update this thin literature by relying on recently declassified archival material to which Burk and Harmon did not have access in the 1990s. Burk, for example, contends that the United States viewed solving the British situation as crucial because of the "special relationship" between the two countries and the role that sterling played in the global economy. This article, in contrast, frames the crisis in terms of economic ideology and the future character of the global economy. Sargent's two-paragraph contention that the IMF crisis represented the incompatibility of economic globalization and autonomous economic polices comes closer to the mark. See Sargent, *A Superpower Transformed*, 196. For an analysis of Britain's relationship to the IMF in the twenty years preceding the 1976 sterling crisis, see Ben Clift and Jim Tomlinson, "Negotiating Credibility: Britain and the International Monetary Fund, 1956-1976," *Contemporary European History*, vol. 17, no. 4 (2008): 545-66.

government as "the most dogmatic since the war…it is now in a hopelessly entrenched position and it will take a crisis to get it…out of the trenches."[106] In the aftermath of the Yom Kippur War of October 1973 and the quadrupling of oil prices, the country suffered from rising inflation and crippling trade deficits. After another coal minters' strike, Heath openly challenged the power of the unions by calling an election on the slogan "Who Governs Britain?" His attempt to form a coalition with the Liberals failed, and Heath resigned in March 1974. The new Labour government under Harold Wilson placed great importance on coming to terms with the TUC, and the two sides agreed to a "Social Contract" whereby the TUC restrained demands for increases in wages in return for social services. The Wilson government believed that it must do everything that it could to uphold the Social Contract, otherwise it would be ousted from power as it had been in 1970.[107]

Maintaining the trust of the TUC, however, proved costly in an era of global economic disruption. Wilson sought to reduce the Public Sector Borrowing Requirement (PSBR) – the budget deficit – from more than £4 billion in 1973-1974 to £2.7 billion in 1974-1975, but inflation, the oil crisis, and expanded public spending caused it to increase.[108] The British position in the balance of payments deteriorated steadily in 1974 and 1975. In August 1975, Healey warned that if the Cabinet did not agree to reduce spending, the country would have to choose among implementing import controls, devaluing sterling, or a taking out a loan from the IMF.[109] The decrease in world commodity prices in 1975 improved the situation in the British current account somewhat, but the deficit remained large ($3.8 billion) and continued poor

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[106] Philip Ziegler, *Edward Heath: The Authorized Biography* (London: HarperPress, 2010), 336.
[107] Burk and Cairncross, *"Goodbye, Great Britain"*, 13.
[108] "Record of a Conversation between the Prime Minister and Federal German Chancellor at 11.00 a.m. in the Palais Schaumburg in Bonn on Wednesday 19 June 1974," June 19, 1974, UKNA, PREM 16/99.
[109] Burk and Cairncross, *'Goodbye, Great Britain'*, 13-20.

economic performance forced Whitehall to request a standby arrangement with the IMF in December 1975.[110] Britain's allies worried whether the British economic deficits stemmed from the "particular factors" of 1975, or whether they expressed deeper problems endemic to the welfare state.[111]

International attention turned in early March 1976 to the value of sterling. In an effort to improve the balance of payments, the Bank of England began to sell sterling on March 4 and cut interest rates the following day. The markets interpreted these measures as an indication that the British wanted a lower exchange rate for their currency, and speculators sold sterling much faster than British authorities had anticipated.[112] As a result, the Bank of England had to negotiate a \$5.3 billion credit from the central banks of the G-10 to cover its losses.[113] With a 20 percent inflation rate, a Briton earning \$24,000 would need a raise of \$9,600 just to maintain the purchasing power of his original salary.[114] The British government received a stand-by credit of \$5.3 billion in the summer of 1976. This sum included \$2 billion from the U.S. Federal Reserve and Treasury, \$800 million from the Deutsche Bundesbank, \$600 million from the Bank of Japan, \$300 million each from the Bank of Canada and the Banque de France, and \$1.3 billion from Switzerland and the Bank for International Settlements.[115] The agreement stipulated that in the event that London could not repay the loan by December, Whitehall would turn to the IMF

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[110] Denis Healey to Johan Witteveen, December 18, 1975, IMF Archives, Washington, D.C., Central Files, Country Files, United Kingdom Files, Box 33.

[111] Referat 204, "Gespräche Bundeskanzler/Bundesminister mit PM Wilson/AM Callaghan am 24.7.1975 in Hamburg," July 22, 1975, PA-AA, B 32 (ZA), Bd. 110334.

[112] On the U.S. Treasury's response to the assault of sterling in March, see William E. Simon, "Memorandum for the Economic Policy Board: The International Monetary Situation," March 31, 1976," Office of Assistant Secretary of International Affairs (OASIA), Chronological Files of Deputy Assistant Secretary for International Monetary Affairs F. Lisle Widman, 1967-1978, F.L. Widman CHRON Mar 1976, Box 8. On West German thinking, see Abteilung 4, "Jüngste Stützungsaktion für das britische Pfund," June 8, 1976, PA-AA, B 202 (ZA), Bd. 109321.

[113] James, *International Monetary Cooperation Since Bretton Woods*, 279-80.

[114] "Good-bye, Great Britain," April 29, 1976, *The Wall Street Journal*, 22. For the U.S. perspective, see William E. Simon, "Memorandum for the President: Financial Support for the United Kingdom," June 7, 1976, David Bishop Skillman Library, Lafayette College, Easton, PA, William E. Simon Papers, Series IIIB, Drawer 27, Folder 13.

[115] Burk and Cairncross, *'Goodbye, Great Britain'*, 45.

for support. At the first G7 Summit in November 1975 at Rambouillet, Wilson had agreed to intervene in the market to support sterling, but at this point Britain could only continue to do so with the loan.

The situation worsened in the fall. "It began to rain in Britain in September," U.S. ambassador Anne Armstrong reported from London. "The good news…ended there."[116] The Bank of England stopped supporting sterling in the exchange market on September 7 and the pound plunged to record low of $1.63 within three weeks. Fearing that it would drop even lower, Prime Minister James Callaghan recognized that the government had to seek international support once again – British reserves of $2-2.5 billion were inadequate to deal with the magnitude of the sterling crisis and that the government had to seek international once again to manage the monetary crisis.[117] Callaghan, who had replaced Wilson in April 1976, had served as Chancellor of the Exchequer during the sterling crisis of November 1967 and feared the ramifications of a similar run on sterling. At the British Labour Party Conference in Blackpool in late September, Callaghan stressed "in a grim and realistic speech" that Britain could not spend its way out of the recession. A Keynesian solution no longer existed to Britain's problems, he admitted to an unhappy crowd.[118] On Healey's advice, the British government announced on September 29 its intention to ask the IMF for a loan of $3.9 billion – the largest amount ever requested.[119] Even this news failed to settle the market; speculators remained unconvinced that Britain could reduce inflation and narrow its deficits. In a television interview, the eminent University of Chicago economist Milton Friedman predicted that Britain would follow Chile and

[116] Armstrong (London) to State, "September in Britain," October 9, 1976, NARA, RG 59, Central Foreign Policy Files, 1973-1979, Electronic Telegrams 1976.
[117] Nigel L. Wicks to Nick Monck, September 28, 1976, UKNA, PREM 16/798.
[118] George Clark, "Mr. Callaghan's Grim Speech Wins Little Conference Applause," September 29, 1976, *The Times*. 1-2.
[119] Secret exploratory talks about a stand-by arrangement had commenced in August.

New York City on the path toward financial collapse, a projection that further eroded international confidence in the pound.[120]

Because of the high stakes, the British overture to the IMF immediately became a matter of international politics.[121] After indicating its intention to seek IMF assistance, Whitehall reached out to the United States and West Germany to negotiate a "safety net" loan to stabilize sterling. Harold Lever, the Chancellor of the Duchy of Lancaster, became a chief proponent of this. "No likely combination of favourable items of news, or policy successes, can now by itself persuade the market that sterling will not go down further," Levy wrote to the prime minister. "Intervention with money must be the main instrument of persuasion for some period ahead." Lever emphasized that the British had "an excellent chance" of receiving loans from the United States and West Germany, particularly if they framed the loan in terms of ensuring London's ability to participate in the financial and defense sectors of the transatlantic community. Furthermore, the participation of Washington and Bonn in the June 1976 loan already demonstrated U.S. and West German sensitivity to British needs. "It seems to me unthinkable," Lever concluded, "that we should flounder into a siege economy because we failed to ask our friends for further help."[122]

Others in the government were not quite as confidant. Callaghan, for example, worried that Washington and Bonn would "seek an element of 'over-kill.'"[123] Early contacts with the

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[120] Robert Hormats to Brent Scowcroft, "Your Meeting with Yeo," October 27, 1976, GFPL, NSA, NSC International Economic Affairs Staff Files, Country File – United Kingdom (1), Box 3.
[121] Callaghan wrote Ford to voice his hope that the IMF would not attach tough conditions so that Britain could maintain its position in the Atlantic Alliance. See James Callaghan to Gerald R. Ford, September 30, 1976, GFPL, NSA, International Economic Affairs Staff Files, Country File – United Kingdom (1), Box 3.
[122] Harold Lever to James Callaghan, October 1, 1976, UKNA, PREM 16/798. For an excellent survey of the pressures on sterling and the options available to stabilize the currency, compare Lever's letter to the arguments presented in "The Policy on Sterling," included as an attachment in Gavin Davies to Bernard Donoghue, October 4, 1976, UKNA, PREM 16/798.
[123] "Memorandum of Conversation," October 8, 1976, UKNA, PREM 16/798.

U.S. Treasury confirmed those suspicions; Healey reported that Washington would not consider safety net arrangements "until we had got our policies right."[124] The Treasury in particular believed that the welfare state and Labour's appeasement of the TUC inhibited Britain's ability to right the ship. Secretary of the Treasury William E. Simon viewed Britain as a sick country that needed to take its medicine. pressing In his memoirs, Simon ridiculed Britain for its mixed economy, writing that "most British intellectuals and political leaders appear to have suckled Fabian socialism with their mother's milk and in consequence learned nothing from the fact that Britain…had been saved from Hitler's hordes by America's free market economy." In particular, he blamed the labor movement – which was "obsessed with Marxist fantasies" – for the destruction of the British economy.[125]

As the British economy deteriorated, Simon and his colleagues in the Treasury saw an opportunity to facilitate a change in the structure of the British economy, particularly rolling back the interference of the central government in the free market. In May 1976, Under Secretary of the Treasury for Monetary Affairs Edwin H. Yeo, III – who had entered government service in 1975 after spending his career at a Pittsburgh bank – outlined a strategy to provide financing for countries facing acute difficulties by attaching conditions such as reductions in public expenditure to aid. He explained that some developed countries no longer had the capacity to cover their current account deficits through borrowing on the capital markets. "The countries in disequilibrium must adjust. <u>The opportunity exists to provide expanded official credit coupled with increased conditionality</u>."[126] During a meeting with the Healey and Lever on October 3,

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[124] Ibid.
[125] Simon, *A Time for Truth*, 37-39.
[126] Quotations come from memoranda written by Yeo that were attached as tabs to Robert Hormats to Brent Scowcroft, "Your Meeting with George Schultz [sic] on Economic Summit," May 24, 1976, GFPL, NSA, NSC International Economic Affairs Staff Files, Economic Summits – Puerto Rico (2), Box 3. The sentence was underlined in the original document.

Yeo made it clear that "public expenditure was not sacred." A loan from the IMF would only help in the short term – "the markets wanted a solution to the U.K. problem and intervention would not work until a solution was found."[127] Other prominent economic officials in Washington such as Federal Reserve chairman Arthur Burns – a self-described "Neanderthal conservative" – and Council of Economic Advisers chairman Alan Greenspan shared this perspective.[128]

The Treasury believed that Britain would set a precedent for how the international community would treat future cases, particularly as IMF negotiations with Italy, Portugal, and Mexico proceeded concurrently. He feared that if "a politically clever country like the U.K." continued to avoid dealing with its deficits, it would inspire others to put off embracing the "distasteful, short-term political consequences" of reining in spending.[129] Yeo added that the "U.K. threaten[s] France and through her, Germany and the rest of [Europe]. From an economic and financial standpoint, the disequilibrium in the U.K…has to be dealt with."[130] Simon agreed, writing, "the success or failure of the effort to nudge the British in a new direction has an even broader impact" and would set a precedent for how countries in similar situations would be treated.[131] The Americans worried that if the British moved even further to the left, communists continued to make progress in Western European countries such as Italy. Western Europe would reorient its overseas priorities to account for the growing economic power of the global South

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[127] "Note of a Discussion at Lunch in No. 11 Downing Street," October 3, 1976, UKNA, PREM 16/798.
[128] Fay and Young, "How the Hard Money Men Took Over Britain: The Day the £ Nearly Died, Part 1," May 14, 1978, *Sunday Times*, 33.
[129] William E. Simon, "Memorandum for the President," November 15, 1976, GFPL, NSA, International Economic Affairs Staff: Files, (1973) 1975-1976, Country File – United Kingdom (1), Box 3.
[130] Edwin H. Yeo, III to William E. Simon, May 15, 1976, Skillman Library, Simon Papers, Series IIIB, Drawer 25, Folder 37.
[131] William E. Simon, "Memorandum for the President," November 15, 1976, GFPL, NSA, International Economic Affairs Staff: Files, (1973) 1975-1976, Country File – United Kingdom (1), Box 3.

(particularly the oil producers), and the United States would lose its influence in the region.[132] This called into question the integrity of the Atlantic Alliance. "There is a serious question as to whether political democracy will survive over most of Western Europe," Deputy Assistant Secretary for Monetary Affairs F. Lisle Widman wrote in the summer of 1976.[133] In the era of détente when fear of the Soviet Union no longer provided a unifying principle for the transatlantic community, this fear resonated with U.S. officials.

The White House and the State Department shared the Treasury's belief that the British needed to make structural changes to their economy, but they wanted to ensure that the political relationship with Britain remained intact. Although the negotiations largely centered on matters of finance, the State Department understood the political ramifications if the government collapsed. William Rogers, undersecretary of state for economic affairs, worried that left-wing members of the British Cabinet would remove the country from the Western financial system, and "the whole system would have come apart."[134] Secretary of State Henry Kissinger asked Simon to remember "the internal problem in Britain" and refrain from driving "most brutal bargain" that he could.[135] Ford shared State's concern about the political implications of the crisis. His education in economics and background as a U.S. senator made him sensitive to both the economic and political aspects of the British crisis, and his amiable personality ingratiated him to the other major heads of state in the industrial democracies. Ford considered Britain as a bulwark in the Atlantic Alliance during a period of social upheaval and socialist advances in

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[132] On Western European policy toward the developing world during the 1970s, see Giuliano Garavini, *After Empires: European Integration, Decolonization, and the Challenge from the Global South 1957-1986*, trans. by Richard R. Nybakken (New York: Oxford University Press, 2012).
[133] F. Lisle Widman to Gerald L. Parsky, "A Concern for Democracy in Western Europe," July 21, 1976, NARA, RG 56, OASIA, Widman Files, FLWidman Chron Jul 1976, Box 8.
[134] William D. Rogers to Henry A. Kissinger, "Britain," October 2, 1976, NARA, RG 59, Records of Henry Kissinger, Nodis Memcons, September 1976 (Folder 6), Box 18.
[135] "TELCON: Sec Kissinger/Secretary Simon," October 28, 1976, Digital National Security Archive (DNSA), Kissinger Conversations: Supplement II, 1969-1977.

Western European countries such as France and Italy. Furthermore, Ford had a personal reason to want to help Britain: he considered Callaghan his "biggest buddy" among all foreign leaders.[136]

In Bonn, policymakers also recognized the dangers of allowing Britain to continue down its current path. A joint position paper of the West German Ministries of the Economy and Finance in June 1976 noted that Britain and Italy represented the only two developed countries that suffered from severe balance of payments deficits. Believing that "internal stabilization was an indispensable prerequisite" for rectifying trade imbalances, the West Germans believed that deficit countries needed to make domestic changes in order to regain the trust of the international community. In this environment, deficit countries "should no longer be helped bilaterally" and should be forced to approach the IMF for help. The assault on sterling reflected a structural problem with the British economy, not a temporary issue that a loan could solve. "If the performance of the British economy improves," a West German Foreign Office paper concluded, "then confidence in the pound will also improve."[137] They believed that the IMF alone had the international standing and authority to force deficit countries to enact domestic stabilization programs.[138]

Most of all, policymakers in Bonn worried that Britain's woes would have inflationary effects in West Germany. In an age of accelerating financial globalization, the decline of sterling had inflationary effects in West Germany. The Deutschemark appreciated 28.6 percent against sterling between the end of 1975 and the end of September 1976, and West German

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[136] Bartholomew Sparrow, *The Strategist: Brent Scowcroft and the Call of National Security* (New York: Public Affairs, 2015), 190-91.
[137] Referat 412, "Währungslage in Großbritannien und Italien," November 8, 1976, PA-AA, B 202 (ZA), Bd. 109321.
[138] Bundesministerium der Wirtschaft und Bundesministerium der Finanzen, "Zum Wirtschaftsgipfel von Puerto Rico: Internationale Währungsfragen," June 21, 1976, BAK, B 136/8483.

policymakers feared that the Deutschemark would come under attack as speculators fled sterling.[139] During the collapse of Bretton Woods, the Deutschemark had faced currency crises in 1969, 1971, and 1973 as "hot money" fled weaker currencies such as the U.S. dollar and French franc in favor of the stronger Deutschemark, an influx of capital that threatened to increase inflation in West Germany.[140] The other industrial democracies also wanted to combat inflation, but in West Germany, it was a *Lebensfrage* – an existential issue.[141] Memories of the 1923 hyperinflation in the Weimar Republic cast a shadow over West German domestic politics, and inflationary policies were tantamount to political suicide. Bundesbank President Karl Klasen held a similar view.[142] Stability was the watchword in Bonn in the postwar period, and British economic strife threatened stability in West Germany.

Schmidt shared his advisers' goal of imposing discipline on Britain, but he, like Ford, also feared that the IMF would insist on overly harsh conditions.[143] Schmidt's experience in government and intellect made him well-positioned to grapple with the political and economic implications of the British IMF crisis. Moreover, his term as the Minister of Finance under Willy Brandt during the collapse of Bretton Woods introduced him to the inflationary pressure that weaker currencies could place on the Deutschemark. "Keynes' methods worked in the 1930's; they don't today, and there is no new Keynes," he had told Kissinger and Ford in May 1975.[144] He did not want to push Callaghan so far that the Labour government would fall. Scholars

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[139] Gruppe 42, "Lage auf dem Devisenmarkt," September 30, 1976, BAK, B 136/11571.
[140] On West German international monetary policy in the late 1960s and early 1970s, see William Glenn Gray, "Floating the System: Germany, the United States, and the Breakdown of Bretton Woods, 1969–1973," *Diplomatic History* vol. 31, no. 2 (2007): 295-323.
[141] Gruppe 21, "Zur Lage der Weltwirtschaft," June 14, 1976, BAK, B 136/8483.
[142] "FRG Visit by Treasurer: Call on Bundesbank," October 27, 1976, UKNA, PREM 16/802.
[143] On West German early thinking about the IMF negotiations, see Referat 204, "Besuch des Herrn Bundeskanzlers in Chequers am 10. Oktober 1976," October 9, 1976, PA-AA, B 32 (ZA), Bd. 110334.
[144] "Memorandum of Conversation," May 29, 1975, NARA, RG 59, Office of the Counselor Helmut Sonnenfeldt, Country and Subject Files, 1973-1976, Germany 1975, Box 3.

Kathleen Burk and Alec Cairncross point out that Schmidt held a special ideological affinity for the Labour Party that stretched back to his days as a Hamburg politician, and the chancellor believed that the Callaghan government offered the best chance for the country to right the ship.[145] As the rise of Eurocommunism threatened countries within the European Community, Schmidt wanted to ensure that Britain remained a stable country. He understood that the collapse of the Callaghan government might bring to power anti-European and Conservative politicians in Whitehall. In a conversation with Yeo, Schmidt said that Conservative leader Margaret Thatcher "is a bitch, she is tough, she lacks scope and cannot lead."[146] The collapse of Britain would, in turn, hinder progress on the construction of a European regional monetary system.[147] Schmidt indicated to Callaghan in early November that he would press his colleagues to provide guarantees for the sterling balances, but he faced stiff opposition, particularly from the Ministry of Finance.[148]

The Americans and West Germans watched carefully as the six-man team of IMF negotiators arrived in London on November 1 for a series of protracted negotiations. As Chancellor of the Exchequer, Denis Healey led the British contingent. He sought to persuade the IMF to accept the smallest possible package of spending cuts in return for the loan, securing conditions that he could sell to his colleagues in the Cabinet – particularly those on the left wing of the Labour Party. Healey did not want to alienate the unions and sever the Social Contract by

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[145] Burk and Cairncross, *'Goodbye, Great Britain'*, 64.
[146] "Memorandum of Conversation," November 3, 1976, DNSA, Kissinger Transcripts, 1968-1977.
[147] "Gespräch des Bundeskanzlers Schmidt mit dem französischen Außenminister de Guiringaud," November 26, 1976, AAPD 1976, Bd. II, doc. 342, 1549.
[148] On Schmidt's offer, see "The IMF Loan and Safety Net for Sterling Balances, etc.," November 1, 1976, Bodleian Library Special Collections, University of Oxford, Oxford, England, James Callaghan Papers, Box 148. Burk and Cairncross correctly point out that Schmidt did not have the authority to commit West German reserves to aid the British; under the Bundesbank Law of 1957, that right belonged to the Bundesbank. Burk and Cairncross, *'Goodbye, Great Britain'*, 66.

requiring severe cuts to public expenditure.[149] Led by Director of the European Department Alan Whittome – a British national who had served in the Bank of England – the IMF team found themselves in a tense atmosphere; they registered under assumed names at their hotel in order to reduce encounters with the press. Journalists interpreted the secrecy as part of the IMF team's desire to "slip quietly and secretly into London to urge tough policies."[150]

Negotiations quickly stalled. The gap between what the IMF wanted and what the British were willing to accept was enormous. At the heart of the discussion between the IMF and Treasury officials lay the issue of the PSBR – the budget deficit – for 1977-78 and 1978-79. As the historian Margaret de Vries notes, the IMF believed even before the 1973 oil crisis that the structure of the British economy caused chronic deficits.[151] The Treasury forecast a PSBR of £10.5-11 billion in 1977-78, but the Whittome countered that the figure should drop to £6.5-7 billion.[152] The British offered a reduction of £1 billion that would place the PSBR at £9.5-10 billion for 1977-78, but the IMF negotiators "were visibly astonished at this. Whittome said that the gap between us now looked unbridgeable. He did not know where to go from this point."[153]

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[149] Labour also faced pressure from the Conservative Party about the prospect of spending cuts. In the House of Lords, former Secretary of Defense Peter Carrington denounced Labour for reducing the budget for national defense. In particular, he pointed to "signs of restlessness" in the Arab-Israeli conflict and the potential for the resumption of hostilities. Neither conditions in the international system nor an inflated budget necessitated cuts to national defense, Carrington declared, and he accused Labour of playing politics by singling out defense, contending that Labour considered it "politically easier" to reduce the defense budget rather than social programs. "Tory Warning to Government not to Cut Defence Spending," December 2, 1976, *The Times*, 6.
[150] de Vries, *The International Monetary Fund 1972-1978, Volume 1,* 469.
[151] Ibid, 461.
[152] Healey sought to convince Whittome that economic indicators actually indicated that the British economy functioned better than the IMF believed; the present slowdown was just "a temporary hiccup" and Britain would return to growth in 1977. See "The Economic Situation and Prospect: Notes for Talk to the IMF Mission, November 8," November 3, 1976, UKNA, T 386/189.
[153] Douglas Wass to Kenneth Stowe, November 18, 1976, UKNA, PREM 16/801. On the breakdown of negotiations, see also John Hunt to James Callaghan, "IMF Negotiations," November 22, 1976, UKNA, PREM 16/802; and Denis Healey, "Note by the Chancellor of the Exchequer: IMF Negotiations," November 22, 1976, UKNA, T 386/190.

Faced with the IMF's stringent demands, Callaghan appealed to Washington and Bonn for help. His strategy had three components. First, the British played on concerns about the integrity of the Atlantic Alliance, claiming that if London could not solve its sterling problem, the British "would be faced with political decisions that would change our whole attitude as a Western partner…. We are spending at the moment, overseas, £600 million a year in Western Germany. If those who want these alternatives win the day, that is the kind of thing that is going to be put at risk."[154] Second, he discussed the political consequences in Britain. If forced to implement severe austerity measures, Labour government would likely lose its supporters and the Conservatives would come to power, a prospect that Callaghan knew unsettled Washington and Bonn because of the Conservatives' "proven inability to get on with the trade unions."[155] Finally, British representatives attempted to convince the international community that Britain was "not prodigal with government expenditure." Its deficit represented 4.9 percent of GDP in 1975, a figure that compared favorably to those of West Germany (6.1 percent) and Italy (11 percent).[156] The issue with the British economy at the moment was the transitory need to satisfy foreign holders of sterling, not an unsustainable structural problem that would require a severe reduction of the PSBR. Furthermore, Whitehall policymakers assured that help was on the way. The Planning Staff of the Foreign and Commonwealth Office wrote that "a rainbow spans the somber horizon of the next few years: the prospect of off-shore oil" from the North Sea. According to estimates in late 1974, the British held the rights to somewhere between two to five

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[154] "Transcript of a Telephone Conversation Between the Prime Minister and President Ford," September 29, 1976, UKNA, PREM 16/798. The following day, Callaghan wrote to Ford to double down on the British position, warning that protracted and difficult negotiations with the IMF could "put at risk this country's contribution as an ally and a partner in the western alliance and its value as a member of the International Trading Community." Callaghan to Ford, September 30, 1976, GFPL, NSA, International Economic Affairs Staff: Files, (1973) 1975-1976, Country File – United Kingdom (1), Box 3. London made similar arguments to Bonn. See, for example, "Aufzeichnung des Ministerialdirektors Lautenschlager," November 16, 1976, *AAPD, Bd. 2*, doc. 325, 1481-82.
[155] "Memorandum of Conversation," October 8, 1976, UKNA, PREM 16/798.
[156] Treasury brief, "The U.K. Economy," November 25, 1976, Bodleian Library, Callaghan Papers, Box 148.

billion tons of oil in their sector of the North Sea. Production began in earnest in 1975, and analysts expected that production would reach 100 million tons by 1979, a prospect that would reverse the balance of payments deficits by the early 1980s.[157]

Callaghan sent his long-time friend Lever to Washington in mid-November to lobby on Britain's behalf. Lever first consulted Kissinger and several State officials on the morning of November 15. The Chancellor of the Duchy of Lancaster spent much of the discussion explaining economic concepts to the secretary–Kissinger had no training and little interest in economics–and how they applied in the British case. Kissinger understood the strategic implications for the Atlantic Alliance, and he responded that his view was that "it should be treated as a political problem." He admitted, however, that he could not do anything until the British presented a "concrete program" to address the deficit. At the close of the meeting, William Rogers gave Lever some encouragement for his upcoming appointment with Simon, assuring the British emissary that Simon was "reasonable about these things. He'll listen."[158]

Simon indeed listened carefully to Lever, but the Treasury proved a tougher audience than Kissinger. As he had with the secretary of state, Lever tried to paint a bleak picture of what would happen if the United States did not intervene with the IMF, warning that further PSBR reductions would likely require cuts in the British defense budget. Worse yet, he suggested that these austerity measures would embolden those who wanted Britain to withdraw from NATO, a

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[157] Planning Staff paper, "The End of the Rainbow: Offshore Oil and British Foreign Policy," December 1974, UKNA, FCO 49/509. Most of the oilfields in the British sector of the North Sea were located on the northern and eastern shores of Scotland. The prospect of oil revenue provided a powerful incentive for Whitehall to ensure that Scotland remained part of the United Kingdom. Running on a platform of independence, the Scottish National Party used the issue of oil in the North Sea to argue that Scotland would be better off as a sovereign state. The party used the slogan: "It's Scotland's oil!"

[158] "Memorandum of Conversation," November 15, 1976, NARA, RG 59, Records of Henry Kissinger, Nodis Memcons, November 1976, Box 19. Kissinger repeatedly stressed to Lever that he did not fully understand the virtues of the various proposals to solve to Britain's economic troubles. The first thing that the secretary of state said to Lever was, "You know, of course, Harold, I could produce total panic among my colleagues by pretending to understand anything about economic affairs or implying that I might become involved in them."

prospect which would mark “the beginning of an irreversible erosion of Britain’s support for the defense of Europe.” Bowing to the demands of the IMF would spell the end of the Callaghan government and bring the Conservatives – “who could not obtain the cooperation of labor” – back to power. Lever “pleaded” that the Americans accept the British judgment that further expenditure cuts would be “counterproductive.”[159]

Simon and his Treasury colleagues, however, fundamentally disagreed with Lever. Unlike Kissinger, they were unmoved by the emissary’s dire political predictions. Instead, they believed that the British used sterling balances as an unscrupulous tactic to “deflect scrutiny from U.K. economic policy.” Before meeting with Lever, Simon penned a memorandum to Ford in which he argued that continuing to loan money to London would merely forestall another inevitable crisis. The main issue was that “the British have lost control over the budget,” he contended, and London needed to rein in its government spending. Washington should support “the IMF’s efforts to negotiate a sound stabilization program which will combine financial support with UK policy changes.”[160] Simon promised Lever that the U.S. government would take everything into consideration, but offered no concrete assurances.[161]

The following morning, Lever had a final session with Ford, National Security Adviser Brent Scowcroft, and NSC staffer Robert Hormats. Before receiving Lever, Kissinger recommended that the president voice sympathy with Lever’s concerns but remain noncommittal. “If we turn down the British,” Kissinger told Ford, “it should not be to Lever – he

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[159] “Memorandum of Conversation: U.K. Negotiations with the IMF,” November 15, 1976, NARA, RG 56, Office of the Deputy Assistant Secretary for International Monetary Affairs: Briefing Papers, 1964-1981, UK-MECONS Jan 1972-Dec 1976, Box 1.
[160] William E. Simon, “Memorandum for the President,” November 15, 1976, GFPL, NSA, International Economic Affairs Staff Files, Country File – United Kingdom (1), Box 3.
[161] “Memorandum of Conversation: U.K. Negotiations with the IMF,” November 15, 1976, NARA, RG 56, OASIA, Widman Files, FLWidman Chron Nov 1976, Box 8.

has a monumental ego and we don't want him going back saying he was kicked in the teeth."[162] Ford promised Lever that he personally would "bend over backwards" for Callaghan – whose friendship he valued – but the president also stressed that he was "deeply concerned about the U.K. and its ramifications on several other international problems."[163]

Lever telephoned Callaghan from Washington on November 17. Aside from the "glorious sunshine" in Washington, he did not have good news. Lever reported that received a "friendly" reception from the Americans but found them "receptive without commitment." The mission had been unsuccessful, and he suggested that Callaghan should expect sympathy and well-wishes, but no aid.[164] Lever's prediction was confirmed when Ford wrote a letter to Callaghan after the meeting to describe his general support for Britain, but he also indicated that Callaghan should proceed with the IMF.[165] It would be "inappropriate" for the U.S. to intervene, he would later write.[166]

In a separate letter to Callaghan three days later, Ford also indicated, however, that the United States would work with the British to settle their sterling balances *after* London had come to terms with the IMF. Scowcroft, who worried about the larger geostrategic consequences of the crisis, encouraged Ford to include this language.[167] Treasury opposed the specific mention of the

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[162] "Memorandum of Conversation," November 16, 1976, GFPL, NSA, Memoranda of Conversations, 1973-1977, Box 21.
[163] "Memorandum of Conversation," November 16, 1976, GFPL, NSA, NSC International Economic Affairs Staff Files, Country File – United Kingdom (1), Box 3.
[164] "Transcript of a Telephone Conversation Between the Prime Minister in his Room at the House of Commons and the Chancellor of the Duchy of Lancaster at the British Embassy in Washington at 1430 Hours on Wednesday, 17 November," UKNA, PREM 16/801.
[165] "Memorandum From the President's Assistant for National Security Affairs (Scowcroft) to President Ford, November 21, 1976, Foreign Relations of the United States (FRUS), 1969-1976, Volume E-15, Part 2, Documents on Western Europe, 1973-1976 (Washington, D.C.: United States Government Printing Office, 2014), doc. 249, 787. The letter is included as an attachment to the memorandum. Scowcroft indicated that Treasury opposed the inclusion of the sterling balances issue, but wrote Ford that he "cannot, in good conscience, recommend you accept deletion of this phrase."
[166] Gerald R. Ford to James Callaghan, November 24, 1976, UKNA, PREM 16/802.
[167] On Scowcroft's role during the crisis, see Bartholomew Sparrow, *The Strategist: Brent Scowcroft and the Call of National Security* (New York: Public Affairs, 2015), 189-94.

sterling balances, but Ford believed that it would give a greater sense of sympathy to the British.[168] "You don't want to get stuck with sinking the British," Kissinger said to Ford.[169] Ford believed that the U.S. "overriding objective" was the stabilization of the British economy and that emphasizing the sterling balances issue was a British tactic to secure financing through another channel, but he also understood that sterling balances "have a psychological importance to the U.K."[170] It could be used as a tool to make the British feel more comfortable with coming to terms with the IMF. This represented an evolution in U.S. thinking – a willingness to discuss support for the sterling balances once the IMF negotiations concluded – and proved an important development during the British Cabinet negotiations.

When the full British Cabinet met on November 23 to discuss the IMF demands for the first time, it was unclear how its members would vote. Britain faced a serious dilemma, and the prime minister had not yet indicated whether he would support accepting the IMF's stringent terms. On one hand, Callaghan recognized that the British government did not have sufficient reserves to intervene in the market to support the exchange rate of the pound. Without a loan from the IMF, the prime minister feared that the pound would enter a free fall, and the resulting effects on prices and unemployment "could break the partnership between the Government and the unions." On the other hand, Callaghan also worried that the conditions that the IMF attached to its offer – notably the £3 billion reduction of government expenditure for 1977-1978 – "could strain the Government's relationship with the trade union movement beyond breaking point and

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[168] "Memorandum From the President's Assistant for National Security Affairs (Scowcroft) to President Ford, November 21, 1976, FRUS, 1969-1976, Volume E-15, Part 2, doc. 249, 787. The letter is included as an attachment to the memorandum. Scowcroft indicated that Treasury opposed the inclusion of the sterling balances issue, but wrote Ford that he "cannot, in good conscience, recommend you accept deletion of this phrase."
[169] "Memorandum of Conversation," November 23, 1976, GFPL, NSA, Memoranda of Conversations, 1973-1977, Box 21.
[170] Brent Scowcroft, "Meeting on the UK Economic Situation," November 19, 1976, GFPL, NSA, Presidential Country Files for Europe and Canada, Country File: United Kingdom (2), Box 15.

put the Social Contract at risk."[171] Even Healey wavered; his earlier support for the loan softened as the protracted negotiations with the IMF continued and the Americans and West Germans proved unwilling to intervene on London's behalf.[172]

Powerful members of the left wing of the Labour Party such as Anthony Crosland, Michael Foot, and Tony Benn strongly opposed the IMF loan. They argued that the British economy was fundamentally sound; the only compelling argument in favor of budget cuts was satisfy foreigners. At the Cabinet meeting, Crosland – whom Callaghan later described as "an intellectual heavyweight with sufficient firepower to take on" Healey – demanded that their focus should be on maintaining the Social Contract, not appeasing the international community.[173] Crosland contended that accepting the IMF's terms would cause deflation, increasing the already high unemployment number – 1.25 million in late 1976 – and add to the PSBR by reducing government receipts. He acknowledged the need for a cut to the PSBR to appease the IMF, but suggested that it should not exceed £500 million.[174] Crosland told his colleagues in the Cabinet:

> The Government should then say to the IMF, the Americans and the Germans: if you demand any more of us, we shall put up the shutters, wind down our defence commitments, introduce a siege economy. As the IMF was even more passionately opposed to protectionism than it was attached to monetarism, this threat would be sufficient to persuade the Fund to lend the money without unacceptable conditions.

Crosland's proposal gained momentum, and the following day, November 24, the majority of the Cabinet opposed the IMF package.[175] Treasury readied a plan to implement import and exchange controls.[176] Healey could count on the support of only

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[171] Cabinet Conclusions, November 23, 1976, UKNA, CAB/128/60/11.
[172] Hickson, *The IMF Crisis and British Politics*, 127.
[173] Callaghan, *Time and Chance*, 435.
[174] Hickson, *The IMF Crisis and British Politics*, 130-32.
[175] Burk and Cairncross, *'Goodbye, Great Britain'*, 87-88.
[176] Ibid, 87.

two members of the Cabinet: Secretary of State for Trade Edmund Dell and Minister for Overseas Development Reg Prentice.

The prime minister reached out to Ford and Schmidt to inform them that the Cabinet found "the [IMF] proposals unacceptable."[177] Callaghan asked Schmidt to send an envoy "to cool down things."[178] The chancellor shared Ford's view of the situation. He worried that the British bloated expenditures would have catastrophic effects for the global economy, but he also wanted to ensure that the Labour government survived. Schmidt told Ford on November 24 that "economically the conditions should be as strict as possible, but they should not place such a political burden on the current government that it would collapse….One must figure out how far he can go without crossing that critical line."[179] `

Although Ford and Schmidt sought to find a balance between facilitating change in the British economy without upsetting the political relationship, their economic advisers continued to take a hardline approach. Schmidt dispatched Undersecretary in the Ministry of Finance Karl Otto Pöhl to London at Callaghan's request to see how Bonn could assist. Pöhl, however, was a kindred spirit of Simon. He was less interested in the political considerations than in ensuring that London take its medicine. To Healey's disappointment, Pöhl warned "against any expectation that the Germans would press the Fund to relax its conditions." When Healey cautioned that "the Cabinet might react by turning to a siege economy," Pöhl answered that he understood the risk.[180] Shortly thereafter, Simon stopped in London on his way to the Soviet Union and held meetings with British officials. Healey warned Simon that "if it came to a choice

[177] "Message From British Prime Minister Callaghan to President Ford," November 23, 1976, FRUS, 1969-1976, Volume E-15, Part 2, doc. 250, 788.
[178] Burk and Cairncross, *'Goodbye, Great Britain'*, 87.
[179] Abteilung Leiter 4, "Aufzeichnung des Telefonsgesprächs des Bundeskanzlers mit Präsident Ford am 24. November 1976, 15.30 Uhr," November 24, 1976, BAK, B 136/8475.
[180] "Notes on a Meeting at No. 11 Downing Street at 715p.m. on Wednesday, 24 November 1976," UKNA, PREM 16/802.

between satisfying the markets and holding the Unions' confidence, the Cabinet would choose the latter." Simon "sympathised" with Healey, but stressed that the British needed to enact a policy that "could be credibly presented as a 'permanent solution' to the UK's problems." "The central problem, Simon lectured Healey, "was to restore the confidence of the finance community."[181] Callaghan made a final overture to Schmidt at the European summit meeting in The Hague on November 29, but Schmidt had come to view the situation in similar terms as Pöhl. During the Summit, Crosland quipped that Schmidt sounded as if he stood on the right of Margaret Thatcher.[182]

As talks stalled, IMF managing director Johannes Witteveen travelled to London to take part in the discussions personally. Whittome believed that only Callaghan's personal involvement could break the deadlock, and Witteveen's arrival in London compelled the prime minister to participate directly in talks as well. On December 1, Witteveen and Callaghan had a "highly unpleasant" first meeting that reflected the clashing priorities of the two parties: while the IMF wanted Britain to satisfy foreign holders of sterling, the Callaghan government sought to defend the Social Contract. Witteveen demanded that the British reduce the PSBR to "restore confidence." Callaghan asked, "Whose confidence?" The IMF director responded that he was thinking of the business community and the market, but Callaghan interjected that Witteveen overlooked the confidence of organized labor in Britain. The IMF demanded a decrease in the PSBR of £2 billion, but Callaghan cautioned Witteveen that if the IMF were unwilling to cut that figure in half, "then the negotiations were at an end." The Cabinet would not accept that figure

[181] "Note of a Meeting Held in the Chancellor of the Exchequer's Room at H.M. Treasury on Sunday, 28 November 1976 at 10.00am," November 30, 1976, UKNA, PREM 16/803.
[182] "Draft: Record of a Meeting of the European Council Held at Binnenhof, The Hague on Monday 29 November 1976 at 1500," UKNA, PREM 16/851.

and would opt for a siege economy.[183] Healey said that the director should "take a running jump."[184]

The decisive Cabinet meeting took place on December 2. Foot and Crosland again led the opposition to the IMF conditions. The Cabinet, however, voted in favor of accepting the terms. The key moment came when Callaghan finally voiced his support for coming to an agreement with the IMF, reluctantly proposing a "three-legged stool" approach that included a cut in the PSBR in 1977-1978 of £1 billion, a safety net for sterling balances, and import deposits. The Cabinet Conclusions state that Callaghan's "statement was an important new factor" that caused Foot and Crosland to change their position. They grudgingly agreed to follow the prime minister because they believed that the unity of the Labour Party depended on backing Callaghan; if it became public that the Cabinet had opposed the prime minister, the Labour government would likely collapse and sterling would crash further. Foot worried about the consequences of unemployment and lack of social services for the British populace, but he feared above all a repetition of the events of August 1931, when the Labour government under Ramsay MacDonald resigned after deep Cabinet divisions over economic policy. Crosland "very coolly" told the prime minister that did not support accepting harsh IMF terms but knew that the government could not survive unless it backed Callaghan.[185]

Why did Callaghan finally voice his support for Healey? He told the Cabinet that although accepting the IMF terms would "have an adverse effect" on the government relationship with the TUC, it would not have as significant an impact on the "public at large." A critical new development was that he received assurances from Ford and Schmidt that they

[183] "Note for the Record: IMF Negotiations," December 1, 1976, UKNA, PREM 16/804.
[184] Denis Healey, *The Time of My Life* (London: Michael Joseph, 1988), 432.
[185] Burk and Cairncross, *'Goodbye, Great Britain'*, 101-02; Callaghan, *Time and Chance*, 438-39.

would come to an agreement about the sterling balances after the government agreed to the IMF's terms. Callaghan believed that addressing the sterling balances was more important for Britain's long-term economic vitality than the IMF loan.[186] Since the mid 1960s when he served as Chancellor of the Exchequer, Callaghan had advocated that the reserve role of sterling be reduced because he thought that they made the British economy vulnerable to speculative assaults. Ford admitted the previous evening that he would likely have to go through Congress to get the money, but he strongly believed that they could strike a deal after the conclusion of an agreement with the IMF.[187] This gave Callaghan more confidence that the British could restructure the economy in a way that would move resources into investments and exports without being undermined by speculative pressure against sterling. He told the Cabinet that this promise to assist "could be politically very helpful domestically."[188]

The Cabinet had finally indicated a willingness to take its medicine. During the first two weeks of December, Treasury officials met with the IMF negotiators and agreed to terms.[189] The IMF continued to play hardball until the end. Healey threatened Whittome that if the IMF continued to demand cuts to the PSBR of more than £1 billion, then Callaghan would call a general election on the sole issue of the IMF loan and the "need to avoid a national humiliation." Healey even warned that London may lead "a world revolt against international institutions."[190] The IMF finally acquiesced. The final terms included a £1 billion fiscal adjustment in 1977-78, plus a sale of £500 million worth of the government's shares in British Petroleum (bringing the

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[186] Burk and Cairncross, *'Goodbye, Great Britain'*, 111. Healey, *The Time of My Life*, 432.
[187] "Conversation Between the Prime Minister and President Ford," December 1, 1976, UKNA, PREM 16/804; and "Memorandum of Conversation," December 3, 1976, GFPL, NSA, Memoranda of Conversations, 1973-1977, Box 21.
[188] Cabinet Conclusions, December 2, 1976, UKNA, CAB/128/60/14.
[189] On the evolution of the negotiations during the first week of December, see John Hunt to James Callaghan, "IMF Negotiations," December 5, 1976, UKNA, PREM 16/805
[190] Healey, *The Time of My Life*, p. 432; and "Note for the Record," December 4, 1976, UKNA, PREM 16/805.

PSBR from £10.2 billion to £8.7 billion). In 1978-79, the government committed to a £2 billion reduction of the budget.[191]

As he prepared to leave office, Ford kept his promises about the sterling balances. U.S. and British policymakers negotiated the deal, the governors of the central banks of the major industrial democracies met at the Bank of International Settlements in Basle to bless the agreement that would extend $3 billion to the British.[192] The agreement shielded British reserves from speculation and protected Britain from an increase in interest rates. In exchange for official holdings of sterling, London would offer negotiable bonds denominated in currencies other than sterling. This reduced the reserve role of sterling, a development that would help insulate Britain from the currency assaults that the country had suffered for decades.[193]

The legacy of the British IMF crisis had a global reach. As U.S. and West German officials predicted, the British IMF crisis set a precedent for the imposition of strict conditionality for loans to deficit countries around the globe. Through their influence in the IMF, conditionality became a tool for Washington and Bonn to liberalize the welfare state externally and require austerity measures in exchange for international aid. Schmidt's tough stance during the Italian negotiations in 1976 earned him the nickname "Diktat di Schmidt" from the Italian newspaper *Il Messaggero*.[194] Conversations with the IMF mirrored those that the British had undertaken in late 1976, and the Italian government complained about the "ganging of [West]

[191] "Note of a Meeting Held in the Chancellor's Room at H.M. Treasury at 10 a.m. on Wednesday 8 December 1976," December 9, 1976, UKNA, PREM 16/806.
[192] C. Fred Bergsten to W. Michael Blumenthal, "Your Meeting Today at 4:45 p.m. on the Sterling Balances Negotiation – Christopher (Kit) McMahon, Executive Director of the Bank of England," January 5, 1977, NARA, RG 56, Records of Assistant Secretary for International Affairs C. Fred Bergsten, 1977-1979, BP-4 Briefing Papers 2 of 4, Box 2.
[193] Callaghan, *Time and Chance*, 446.
[194] Spohr, *The Global Chancellor*, 26.

Germany and the United States with the Fund."[195] In 1977, the Peruvian junta scaled back government expenditure, acquiescing to the IMF's demand of reducing public spending through wage freezes and the liberalization of trade restrictions. A similar pattern unfolded in Mexico, where President José López Portillo was forced to implement austerity measures despite fears that they would antagonize government relations with the unions.[196] By 1979, journalist Ron Chernow described the IMF as "the newest and finest expression of imperialism."[197] This new role for the IMF helped ensure that bloated national budgets would not export inflation and instability, and the retrenchment of the British state helped the ascendency of neoliberalism.

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The neoliberal turn played a crucial role in the resurgence of the West, but it came at a high social price. As the North-South dialogue did little to assist non-oil-producing countries in the global South, they suffered from the high costs of raw materials with little relief from the global North. The ability of the United States to attract petrodollars left few for others. The British IMF crisis began a global process of domestic adjustment that would spread to the rest of Europe and the developing world, and the IMF insisted on cuts to social services as terms for its loans. The conditionality that the IMF attached to its loans may have helped the countries regain economic stability, but the populations in Britain and elsewhere struggled to adapt to the removal of safety nets and higher rates of unemployment.

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[195] James, *International Monetary Cooperation Since Bretton Woods*, 284. For the Italian formal request to the IMF, see "Italy – Recent Economic Developments," April 19, 1977, IMF Archive, SM/77/84; Gaetano Stammati to Johan Witteveen, April 6, 1977, IMF Archive, included as attachment to EBS/77/98.
[196] Hal Brands, *Latin America's Cold War* (Cambridge, MA: Harvard University Press, 2010), 153-55.
[197] Ron Chernow, "The Roughest Bank in Town," February 3, 1979, *Saturday Review*, 18.

Chapter 5

“You Must Get Your Head Out of the Clouds”: The Twin Oil Crises Behind the Iron Curtain

When the oil crisis erupted during the Yom Kippur War in October 1973, policymakers across the socialist bloc rejoiced in *Schadenfreude*. Viewing the crisis as an expression of the decline of imperialist power in the developing world, the socialists voiced their solidarity with the Arabs and even encouraged them to nationalize Western oil properties. Pointing to Soviet reserves of natural gas and oil, most scholars have depicted the Soviet Union as a beneficiary of the energy crisis, arguing that it offered a “golden opportunity” for Moscow.[1] The quadrupling of the price of oil provided the Kremlin with certain opportunities, including the influx of capital to

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[1] The eminent scholar of the Russian and Soviet energy industry Marshall I. Goldman uses this language in *Petrostate: Putin, Power, and the New Russia* (New York: Oxford University Press, 2008), 46 and called the energy crisis “a bonanza” for the USSR in his earlier work *The Enigma of Soviet Petroleum: Half-empty or Half-full?* (London: George Allen & Unwin, 1980), 88-92. Archie Brown also characterizes the oil crisis in the West as an “energy bonanza for the Soviet Union.” See Brown, *The Rise and Fall of Communism* (New York: HarperCollins, 2009), 415-16. For other works that make similar arguments, see Arthur Jay Klinghoffer, *The Soviet Union and International Oil Politics* (New York: Columbia University Press, 1977), 173-78; Stephen Kotkin, *Armageddon Averted: The Soviet Collapse 1970-2000* (New York: Oxford University Press, 2001), 15-19; Christopher Miller, *The Struggle to Save the Soviet Economy: Mikhail Gorbachev and the Collapse of the USSR* (Chapel Hill, NC: University of North Carolina Press), 76. and Vladislav M. Zubok, *A Failed Empire: The Soviet Union in the Cold War From Stalin to Gorbachev* (Chapel Hill, NC: University of North Carolina Press, 2007), 249-50. Martin Malia goes so far as to argue that the Soviet “petrodollars” allowed the Soviet Union to remain competitive with the West “by entering into a parasitical economic relationship with it.” See Martin Malia, *The Soviet Tragedy: A History of Socialism in Russia, 1917-1991* (New York: Free Press, 1994), 377-78. Diane Kunz adds that the oil crisis “granted the faltering Soviet economy a stay of execution.” Diane Kunz, *Butter and Guns: America’s Cold War Economic Diplomacy* (New York: Free Press, 1997), 251. Others appreciate the link between Soviet energy and price developments on the capitalist market, but they tend to focus on the 1980s and particularly emphasize the price crash in 1986 and its effect on the collapse of the Soviet Union. See, for example, Yegor Gaidar, *Collapse of an Empire: Lessons for Modern Russia* (New York: Brookings, 2007), particularly 122-32. With their use of econometrics but no archival research, economists Elisabeth Beckmann and Jarko Fidrmuc come closer to the mark by concluding that the energy crisis caused a disruption in intra-CMEA trade, but their argument that CMEA responded by “turning inwards” does not comport with the documentary record. See Elisabeth Beckmann and Jarko Fidrmuc, “Oil Price Shock and Structural Changes in CMEA Trade: Pouring Oil on Troubled Waters?,” *The European Journal of Comparative Economics* vol. 9, no. 2 (June 2012): 31-49. Finally, this chapter also pushes against those who have claimed that the oil crisis did not have a significant impact on the collapse of East Germany. See Ray Stokes, “From Schadenfreude to Going-Out-of-Business Sale: East Germany and the Oil Crises of the 1970s,” in *The East German Economy, 1945-2010: Falling Behind or Catching Up?*, ed. by Harmut Berghoff and Uta Andrea Balbier (Washington, DC: German Historical Institute; and New York: Cambridge University Press, 2013). Evidence presented in this chapter and the one that follows shows, in contrast to Stokes’ argument, that East German policymakers believed that the oil crisis posed an existential threat to the state.

invest in a military buildup, purchase goods and grain on the world market, and pad the salaries of high-ranking Soviet officials. The Soviet trade account swung from a deficit of $1.7 billion in 1973 to a surplus of about $1 billion in 1974.[2] Moscow also benefitted from the Gulf producers' sudden acquisition of wealth – the profits of the Middle Eastern producers allowed them to go on shopping sprees to purchase Soviet arms and military equipment, providing the Kremlin with an infusion of cash that could be used to support revolutionary nationalists across the global South.

Closer inspection of the documentary record, however, reveals that the short-term consequences of the energy crisis proved less beneficial for the Soviet Union than the standard historical interpretation suggests. This chapter demonstrates that the Soviet leadership did not, in fact, consider the energy crisis to be the "golden opportunity" that many have assumed. It was the most dramatic of the global economic shocks of the mid 1970s that originated in the capitalist world but had catastrophic effects within the socialist bloc. "In many capitalist countries the prices of gas, oil and other raw materials are rising," Soviet General Secretary Leonid Brezhnev told his East German counterpart Erich Honecker in June 1974. "We must find a way to deal with this problem in the world economy because it affects us all in certain ways."[3]

This chapter contends that the oil crisis had debilitating effects on the socialist bloc and hastened socialism's collapse by placing severe pressure on CMEA's economies. The chapter proceeds in three sections. First, it shows that the oil crisis was a turning point in the Soviet Union's relations with Eastern Europe, marking a crucial moment when Moscow began to view its informal empire in Eastern Europe as a burden rather than an asset. Soviet policymakers

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[2] NATO APAG Meeting, "U.S. Discussion Paper on Trade and Natural Resources in the East-West Context," April 14-17, 1975, National Archives and Records Administration II (NARA), College Park, MD, RG 59, Records of Henry Kissinger, 1973-77, Briefing Memos, 1975 Folder 6, Box 14.

[3] "Niederschrift über die Gespräche zwischen dem Ersten Sekretär des Zentralkomitees der SED, Erich Honecker, und dem Generalsekretär des Zentralkomitees der KPdSU, Leonid Iljitsch Breshnew, am 18. Juni 1974 in Moskau, Kreml," Stiftung Archiv der Parteien und Massenorganisationen der DDR im Bundesarchiv (SAMPO), Berlin, Germany, DY 30 IV 2/2.035/55.

wanted to take advantage of the higher prices on the world market, but they also recognized that they had significant problems extracting and transporting their energy reserves. This meant that they did not have enough energy to export to both the free world and satisfy demand within the socialist bloc. As the primary supplier for the socialist bloc's energy needs, the Soviet Union came under pressure to cushion the blow of increased energy prices on the capitalist market for its energy-dependent allies in Eastern Europe. This dilemma compelled Moscow to make a choice about whether to emphasize exporting energy to the West for hard currency, or meeting demand in Eastern Europe at a severely subsidized price.

Moscow selected the former. It desperately needed hard currency to compensate for agricultural shortcomings at home, to continue to attract Western firms to help develop the Soviet energy industry, and to pursue an expansive foreign policy. The Soviet Union could not accomplish these objectives while maintaining the subsidies to Eastern Europe. It imposed a price hike on oil within CMEA to bring the price more in line with world market prices and redirected an increasing share of its oil for sale to the industrial democracies.

Second, the unwillingness of the Soviet Union to meet the energy demands of its allies posed a significant threat to socialism in Eastern Europe.[4] The Eastern Europeans depended on cheap Soviet energy to fuel their export industries, and they increasingly had to turn to the world market to fulfill their needs and pay market prices that they could not afford. The Soviets encouraged the Eastern Europeans to cooperate in joint-CMEA efforts to exploit Soviet energy

[4] The effects of the oil crisis in Eastern Europe has gone unnoticed beyond a few Eastern European specialists. See, for example, Jeffrey Kopstein, *The Politics of Decline in East Germany, 1945-1989* (Chapel Hill, NC: University of North Carolina Press, 1996); Stephen Kotkin, *Uncivil Society: 1989 and the Implosion of the Communist Establishment (*New York: Modern Library, 2009); Charles S. Maier, *Dissolution: The Crisis of Communism and the End of East* Germany (Princeton, NJ: Princeton University Press, 1997); Kazimierz Poznanski, "Pricing Practices in the CMEA Trade Regime: A Reappraisal," *Europe-Asia Studies*, vol. 45, no. 5 (1993): 923-30; and Andre Steiner, *The Plans That Failed: An Economic History of the GDR*, tr. By Ewald Osers (New York: Berghahn, 2010).

reserves in isolated regions of the Soviet Union and develop alternative sources of energy, particularly nuclear energy. These efforts bore meager fruit. The rising prices of commodities ranging from energy to coffee hurt the balance of payments of the socialist states, and they had to significantly increase exports just to tread water. The changing terms of trade within CMEA after the Soviet price hikes quickly led to Eastern European deficits with the Soviet Union. Thus, Eastern Europe had to contend with the twin oil shocks of higher prices in both the socialist and non-socialist world.

Third, the twin oil crises forced the Eastern Europeans further into the arms of Western financial institutions. Eastern European regimes were unwilling, for political reasons, to embrace austerity to correct their deficits and shift the burden of adjustment onto their populations. They did not want to ration goods or raise domestic prices – the Polish uprising in the summer of 1976 and the coffee crisis in East Germany in 1977 demonstrated the danger that such policies posed. Policymakers chose instead to import the necessary goods from the West. In order to pay for these imports, Eastern European governments had to take out more loans from Western banks with increasingly harsh terms. Debt soared, and the Eastern Europeans ironically found themselves increasingly dependent on the inflow of capital from the West to ensure that socialism worked at home.

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When the Middle Eastern oil producers wielded the “oil weapon” against the West, the socialists in the Eastern bloc cheered. The Soviet press cast the oil crisis as an expression of anti-imperialism, the oppressed former colonies of the Western powers asserting their economic sovereignty. *Sotsialisticheskaya Industriya* applauded OPEC’s “attempts to escape from the robbery and exploitation of their natural resources, which will continue in the future.” Soviet media defended the producers' right to raise oil prices in order to regain lost profits caused by upheaval in the Western monetary system and the recent decline of the U.S. dollar. They described the crisis as a manifestation of the continuing collapse of capitalism. In a speech commemorating the anniversary of Lenin's death, Boris Ponomarev, the head of the International Department of the CPSU Central Committee described the oil shock as a sign of a "qualitative move forward in the development of the general crisis of capitalism." The crisis aggravated the contradictions between the capitalist power centers in the United States, Western Europe, and Japan, *Pravda* added, and "has served…as a detonator of the long imminent explosion of the very acute contradictions" in the capitalist world. Moscow radio also, however, used the opportunity to renew the call for the increased energy ties with the West – particularly the reluctant United States – and indicated that the Soviets looked forward to the prospect of exporting Siberian natural gas to heat New York City.[5]

More broadly, the socialists saw the oil crisis as the most dramatic example of the West's decay. The Department of International Relations of the Socialist Unity Party (SED) Central Committee acknowledged that "imperialism remains a dangerous and powerful enemy." The imperialist powers, "often supported by the Chinese leadership," still continued to work against "the positive changes in the world and to restore the status quo." Nevertheless, the socialists believed that conditions in the international system favored them. The oil crisis marked a crucial turning point. "For the first time in their history," the report continued, "the capitalists have lost full control of the production and the price of raw materials, above all oil. This leads to a

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[5] The articles are summarized and cited in: H.R. Mackenzie to Wright, "Soviet Comment on the Energy Crisis and the Oil and Money Weapons," February 14, 1974, United Kingdom National Archives (UKNA), London, England, FCO 28/2609.

decrease and disruption in the profits and the power of international monopoly capitalism."[6] The East German Institute for International Politics and Economics believed that the oil crisis aggravated "other chronic contradictions of the imperialist system," including accelerating inflation, high unemployment, competition among imperialist powers, and chaos in the international monetary system. "The fundamentally changed energy and commodity situation" hurt the balance of payments in the industrial democracies and could contribute to an "extensive crisis."[7] A paper in the East German State Planning Commission concluded that the oil shock "intensified the existing general crisis within the capitalist system, particularly the chronic energy, currency, and financial crises."[8]

As the Soviets and their socialist brethren celebrated the Western disaster, they publicly portrayed themselves as insulated from the crisis' effects. At the United Nations in April 1974, Soviet Foreign Minister Andrei Gromyko declared that the "energy crisis has not been brought about by nature, but by social and political causes. The fact that the socialist world has virtually not been affected by it is clear evidence of this."[9] As they cheered the embargo, the Soviets also quietly undermined it by supplying the United States and the Netherlands with oil. The former, for example, had only received $7.5 million worth of Soviet oil in 1972. This amount increased to $76.2 million in 1973, and $37.3 million in the first two months of 1974 alone.[10] A U.S. energy analyst claimed that the opportunistic Soviets would "snatch the 'world's most greedy'

[6] Abteilung Internationale Verbindungen im ZK der SED, "Die Verwirklichung der Beschlüsse des VIII. Parteitages der SED auf internationalen Gebiet," December 17, 1975, SAMPO, DY 30/IV B 2/20/2.
[7] Institut für Internationale Politik und Wirtschaft, "Zu einigen Entwicklungstendenzen der Wirtschaft in den kapitalistischen Hauptländern 1974," February 1974, SAMPO, DY 30/J IV 2/2J/5198.
[8] No author, "Standpunkt der DDR zur Gestaltung der RGW-Preise 1976-1980," May 30, 1974, Bundesarchiv Berlin-Lichterfelde (BAB), Berlin, Germany, DE 1/58577.
[9] Klinghoffer, *The Soviet Union and International Oil Politics*, 170.
[10] Bruce W. Jentleson, *Pipeline Politics: The Complex Political Economy of East-West Energy Trade* (Ithaca, NY: Cornell University Press, 1986), 138-39.

title for sure."[11] Despite protestations from the developing world, the Soviets and Eastern Europeans refused to participate in the North-South dialogue, claiming that they bore no responsibility for the underdevelopment of the global South because they did not have an imperialist past.

The socialists' public posture belied their increasing dependence on conditions in global capitalism. Some Soviet policymakers, the deputy head of the International Department of the Central Committee Anatoly S. Chernyaev wrote, believed that the East could "sit out" the energy crisis in the West.[12] It soon became clear, however, that they could not. Many Eastern European and Soviet officials privately acknowledged that the CMEA would suffer significantly from the oil crisis. Czechoslovak Deputy Prime Minister and Chairman of the State Planning Commission Thus Hůla wrote in a December 1973 article in Prague's *Rudé Právo*, "It is precisely the present international situation…which shows the increasing interdependence of the economy of all countries, that shows how local conflicts disturb life in distant countries which might not be directly involved in the conflict concerned."[13] The ninth session of the Central Committee of the Socialist Unity Party in East Germany added that "meeting the growing energy and raw materials requirements is a 'world problem' whose solution demands considerable efforts from all socialist countries."[14] Despite the initial euphoria at the misfortune of the industrial democracies, the effects of the oil crisis in the West transcended the Iron Curtain and soon wreaked havoc on CMEA.

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[11] Frank J. Gardner, "Not a Bad Profit for the Soviets – 300%!," *The Oil and Gas Journal*, vol. 72, no. 14 (April 1974), 51.
[12] Diary of Anatoly S. Chernyaev, October 26, 1974, DNSA.
[13] Thus Hůla in *Rudé Právo*, published on December 18, 1973. Quoted in S.J. Barrett, "Soviet Oil Supplies to East and West Europe," December 20, 1973, UKNA, FCO 28/2388.
[14] Gerhard Schürer to Erich Honecker, "Referat zum Volkswirtschaftsplan," December 14, 1973, BAB, DE 1/58701.

The higher prices on the world market offered Moscow the opportunity to capitalize on exports to the non-socialist world, but policymakers in CMEA realized that the oil shock also threatened the cohesion and integrity of the Eastern bloc. The Soviets could not continue to sell oil to their clients at the low price of 14 rubles per ton when it was selling for 80-120 rubles on the capitalist market – the opportunity costs of subsidization at that level were too high – but they also knew that an increase in the price would hurt the energy-dependent economies of Eastern Europe. Chernyaev noted in his diary in October 1974, "if we raise the price of oil and other raw materials, then the economies of our fraternal countries, which were developed under our influence and pressure, will collapse in a few months. The political implications of this are clear!"[15] Since 1958, the Soviet Union adjusted its prices within CMEA every five years to reflect the average price of oil on the world market during the previous five years. The Soviets sold energy to the Eastern Europeans at prices that were a bit higher than on the world market, but they accepted inferior industrial goods in return at inflated prices. After the oil shock of 1973, continued adherence to this pricing mechanism meant that the Soviets sold oil within CMEA for 80 percent less than what they could receive the world market.[16]

Engaged in a competition between two ways of organizing political economy, Moscow understood that socialism's viability rested on its ability to compete with capitalism. The energy crisis hurt the productivity of Eastern European factories and crippled their balance of payments with the non-socialist world, and the economic situation only worsened as time went on. Eastern Europe remained the crown jewel in the Soviet informal empire. The introduction of ICBMs meant that the region no longer offered the same defensive buffer zone against invasion from the West that it had in the early days of the Cold War, but Moscow still believed that the collapse of

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[15] Diary of Anatoly S. Chernyaev, October 26, 1974, DNSA.
[16] Ouimet, *The Rise and Fall of the Brezhnev Doctrine in Soviet Foreign Policy*, 88.

the socialist system in one of the Eastern European countries posed an existential threat to Soviet national security.[17] Eastern Europe, however, required an increasing economic subsidy for socialism in the region to stay afloat, demanding the raw materials that Moscow wanted to sell instead to the capitalists for hard currency. As William J. Ouimet notes, Moscow had to choose between pursuing its national economic interest and protecting the economic integrity of communism in Eastern Europe, "two elements long considered free of any contradictions."[18]

Faced with a dilemma, the Soviets chose to increase exports to the West. They determined that the smooth functioning of the Soviet economy required that Moscow preserve its resources and decrease the subsidies to Eastern Europe. Soviet Secretary of the Central Committee of the CPSU Konstantin Katushev contended that "as long as prices on the world market fluctuated, prices in the socialist world must fluctuate to match them."[19] The "extraordinary developments" on prices in the world market demanded "new considerations" for the structure of prices within CMEA.[20] The Soviets informed the Eastern Europeans that beginning in 1975, the price of oil (and natural gas) would change each year, using 1973 and 1974 as base prices. After negotiating with the Eastern Europeans (below), this proposal was adapted to use the average of world market prices during the previous five years as a concession to Eastern European importers. The current agreement stipulated a price of 14 rubles per ton, but in 1976 the price would rise to 35 rubles per ton. Similarly, the price of natural gas would rise from 14.25 rubles to 31 rubles per cubic kilometer.[21]

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[17] For a discussion of Eastern Europe's value to the Soviet Union, see Savranskaya, "The Logic of 1989."
[18] Ouimet, *The Rise and Fall of the Brezhnev Doctrine in Soviet Foreign Policy*, 88.
[19] "Information über eine Konsultation des Mitglieds des Politbüros und Sekretär des ZK der SED Genossen Hermann Axen, im ZK der KPdSU am 18. November 1974," SAMPO, DY 30/IV/2/2.2035/55.
[20] "Niederschrift über ein Gespräch zwischen Gen. Erich Honecker, Erster Sekretär des ZK der SED, und Genossen Konstantin Fjodorowitsch Katuschew, Sekretär des ZK der KPdSU," August 12, 1974, SAMPO, DY 30/IV/2/2.2035/55.
[21] Werner Jarowinsky to Erich Honecker, "Preis für Erdöl- und Erdgaslieferungen der UdSSR im Rahmen der Abkommen über Investionsbeteiligung," June 26, 1975, SAMPO, DY 30/8935.

Why did Moscow choose to pursue its national economic advance at the expense of its allies? A chief concern that drove Moscow to reduce its subsidization of Eastern Europe was its need for convertible currency.[22] In particular, the Soviets required cash to pay for grain imports from the United States. Poor harvests in 1972 and 1975 forced Moscow to import about $3 billion worth of grain from the West. "Bad harvests have been a millstone around our necks," Kosygin admitted in December 1976.[23] Factors for the shortages ranged from the unpredictable climate and poor quality of the soil to the inefficiencies of the collective farming system. In a Soviet republic such as Kazakhstan, Brezhnev told Eastern European leaders in March 1975, the unpredictability of farming conditions could produce a billion poods of grain one year but only 400 million the next.[24] Despite its status as the biggest oil producer in the world, even Soviet farms suffered from fuel shortages for tractors and trucks. This forced Moscow to sell even more oil to the West for grain, further exacerbating the fuel crisis on farms.[25] In 1973, the Soviet Union exported 11-12 million tons of oil to the non-socialist world, Vladimir Inozemtsev said. In 1976, however, the USSR would have to increase that figure to 32 million tons "because of complications in the balance of payments."[26]

The United States was the largest supplier of grain to the Soviet Union. In an age of global food shortages, agriculture assumed a larger role in geopolitics. President Ford encouraged these sales, believing that agricultural exports would help finance U.S. petroleum

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[22] This argument comports with Suvi Kansikas's chapter "Calculating the Burden of Empire: Soviet Oil, East-West Trade, and the End of the Socialist Bloc," in *Cold War Energy: A Transnational History of Soviet Oil and Gas*, ed. by Jeronim Perovic (Cham: Springer International Publishing, 2017).
[23] Willi Stoph, "Information über die Beratung mit Genossen Kossygin am 10.12.1976 in Moskau," December 10, 1976, BAB, DE 1/58569.
[24] "Record of Conversation of Brezhnev with Leaders of Fraternal Parties of Socialist Countries," March 18, 1975, History and Public Policy Program Digital Archive, US Library of Congress, Manuscript Division. Dmitrii A. Volkogonov Papers, Reel 16, Container 24. Translated by Svetlana Savranskaya for the National Security Archive.
[25] Georgi Arbatov, *The System: An Insider's Life in Soviet Politics* (New York: Random House, 1992), 216-17.
[26] "Niederschrift über die Beratungen mit Genossen Inosemzew zu Hauptfragen der ökonomischen Beziehungen zwischen der DDR und der UdSSR für den Zeitraum nach 1980," July 16, 1976, SAMPO, DY 3032/1529.

imports in an era of high prices and provide an additional foreign market for American farmers.[27] Moscow hoped to make barter agreements to make grain purchases so that it would not have to use its limited supply of hard currency. The passage of the Jackson-Vanik amendment to the Trade Act in January 1975 – American legislation that withheld most-favored-nation status from the Soviet Union as punishment for restricting Jewish emigration – hindered the Soviets' ability to penetrate the U.S. market, however. Moscow vociferously protested the amendment, accusing Washington of meddling in internal Soviet affairs. The amendment "sour[ed] the atmosphere of détente," the Soviet ambassador in Washington believed, and denied the Soviets opportunities to export goods to the American market in exchange for grain.[28] The Stevenson Amendment, passed by Congress in late 1974, also placed a $300 million ceiling on U.S. credits to the Soviet Union for the next four years, making impossible any Soviet plan to collaborate with American companies to develop Soviet energy resources in western Siberia.[29] The sale of oil and natural gas were the only commodities that Moscow could export in amounts to the West that brought in significant hard currency. By 1976, revenue from energy exports accounted for 80 percent of Soviet hard-currency income (including 50 percent from oil exports).[30] The U.S. Treasury estimated that the poor harvests substantially raised the Soviet hard currency import

[27] Paul W. MacAvoy to Bill Seidman, "Status Report on Soviet Grain Purchases," July 24, 1975, Gerald R. Ford Presidential Library (GFPL), Ann Arbor, MI, Presidential Handwriting File, Trade: Grain Sales to Soviet Union (1), Box 45. Other significant exporters of grain to the Soviet Union included Canada, Australia, Argentina, and the European Community. For a breakdown of Soviet grain imports by producing country from 1972-1980, see Lippert, *The Economic Diplomacy of Ostpolitik*, 163.
[28] Anatoli Dobrynin, *In Confidence: Moscow's Ambassador to America's Six Cold War Presidents* (New York: Random House, 1995), 334
[29] Werner D. Lippert, *The Economic Diplomacy of Ostpolitik: Origins of NATO's Energy Dilemma* (New York: Berghahn, 2011), 137.
[30] David S. Painter, "From Linkage to Economic Warfare: Energy, Soviet-American Relations, and the End of the Cold War," in *Cold War Energy: A Transnational History of Soviet Oil and Gas*, ed. by Jeronim Perović (New York: Palgrave MacMillan, 2017), 286.

requirements in 1975 to about $14.2 billion, creating a total trade deficit of over $6.3 billion for the year.[31]

In addition to a crisis in agriculture, preexisting Soviet commitments to the Western Europeans also directed energy away from Eastern Europe. The Soviet Union had pursued energy deals with the West to help develop its energy industry, and now Moscow had to supply oil and natural gas to the industrial democracies in return for their equipment and investment. Chronic difficulties in the energy sector, however, burdened the Soviets to fulfill their contractual obligations to the Western Europeans. The Soviets failed to deliver to France, for example, 1.5 million tons of crude in 1972 and 1.3 million tons in 1973, figures that represented 37.5 percent and 21.7 percent of the agreement, respectively.[32] In January 1974, shortly after OPEC announced that it would increase oil prices yet again, Baibakov admitted that the Soviets were already paying penalties for not delivering the requisite amounts.[33] West German Ministry of Economics official Hans Schüssler warned the Soviets that disruptions in deliveries "caused not so much economic as political damages" because they "weakened the faith of the USSR as a trading partner and gave additional ammunition to opponents of developing economic ties with the USSR."[34]

The Soviets had to do everything that they could to honor these agreements; otherwise, they feared, the industrial democracies would refuse to cooperate on future projects. They expected business relationships with Western firms to last and wanted to ensure continued

[31] Treasury background paper, "Implications of the Growing External Debt of the Communist Countries," July 1976, GFPL, L. William Seidman Files, East-West Foreign Trade Board: Background Material, July 1976, Box 56.
[32] "Soviets Falling Short on Exports to West," *The Oil and Gas Journal*, vol. 72, no. 28 (July 1974), 25
[33] "Information über das Gespräch des Genossen Erich Honecker mit Genossen Nikolai Baibakow," January 2, 1974, BAB, DE 1/58584.
[34] "Zapis' besedy s rukovoditelem podotdela dvustoronnego ekonomicheskogo sotrudnichestva ministerstva ekonomiki FRG Gansom Shyusserom y V. Falin," no date, but in folder of documents from 1974, Rossiiskii gosudarstvennyi arkhiv ekonomiki (RGAE), Moscow, Russia, f. 413, op. 31, d. 6635.

Western interest. Commenting on the change in Soviet commercial attitudes, U.S. ambassador in Moscow Walter Stoessel wrote in September 1976, "it can be said that in the past Soviet technological imports were intended to help achieve autarky, but this is no longer the case….[T]he development of Siberian resources and the heightened emphasis on quality of output and work-effectiveness are programs which can only be realized through a long-term association with foreign enterprises."[35] As Soviet energy production increased, the West claimed the majority of the increase; shipment of Soviet oil to the non-socialist world grew rapidly, going up 40 percent in 1975. In contrast, Soviet exports to Eastern Europe rose only 8 percent.[36]

Finally, the Soviet Union became a truly global power in the 1970s and needed to use the hard currency generated from its energy exports to pursue its geopolitical ambitions across the world. As Jeremy Friedman notes, Moscow put to rest any skepticism from the 1960s that it would support revolutionary nationalism in the global South. Soviet aid to Hanoi increased, Moscow's support of the Arab struggle against Israel looked ironclad, and the Kremlin augmented its footprint in Africa. Since 1964, the Soviet Union had concentrated on building a strategic navy and a fleet of transport aircraft that could compete with the U.S. military. It launched its first aircraft carrier–the *Kiev*–in 1975. The scramble for Africa in the mid 1970s in battlegrounds such as Angola turned the continent into a showroom for Moscow to demonstrate its ability to project power across the globe. The Soviets acquired an overseas base, in Somalia. As a means of paying for their expansion, Moscow depended on the profits earned from the energy trade.[37]

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[35] "Ambassador Stoessel's Final Report Cabled from Moscow on September 9, 1976, on the State of the USSR and US-Soviet Relations," GFPL, NSA Presidential Country Files for Europe and Canada, Germany (7), Box 6.
[36] "Record Oil Exports by Russia to West," May 25, 1976, *The Times*.
[37] Zubok, *A Failed Empire*, 249.

Moscow offered to defer receipt of payments and extended low-interest loans to help their friends pay the higher costs, but the rising price of oil had an enormous effect on the balance of trade between the Soviet Union and Eastern Europe. The Eastern Europeans vehemently protested the new arrangement. Patolichev characterized the new oil price as the "anti-imperial price" – a description that a prominent East German official characterized as "highly questionable."[38] Hungarian policymakers worried about their trade deficit with the Soviets and informed Moscow that they needed more assistance in order to increase the production of machinery. Their exports of machinery contained materials obtained with hard currency, and asked for an increase in the delivery of a variety of raw materials. Hungarian Chairman of the State Planning Commission István Hetényi remembered that Moscow "said no. Export more, but we cannot increase our exports. We said that under those conditions, we could not increase our exports. So we built up debts between 1975 and 1980." The deficit over those five years ultimately totaled about 676 million rubles.[39] The increase in oil prices played a crucial role in this deficit. Hungary paid 68-70 rubles per ton in 1979 in comparison to 14 rubles per ton in 1974.[40]

The disruption in the terms of Soviet energy exports shook the foundation of Eastern European planning. While the industrial democracies scrambled in the aftermath of OPEC's production reductions, the Eastern bloc took comfort in the fact that the Soviet Union supplied its energy needs at a fixed price. Reflecting on the hike in world oil prices, the director of the East German State Planning Commission Gerhard Schürer wrote in December 1973, "Trading with the USSR secures us the crucial part of the raw materials we need to supply our national

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[38] "Information über eine Konsultation des Mitglieds des Politbüros und Sekretär des ZK der SED Genossen Hermann Axen, im ZK der KPdSU am 18. November 1974," SAMPO, DY 30/IV/2/2.2035/55.
[39] Quoted in Stone, *Satellites and Commissars*, 54-55.
[40] Goldman, *The Enigma of Soviet Petroleum*, 101.

economy at a stable price. In the speculative price movements of commodities on the capitalist world market, one cannot estimate this fact highly enough."[41] The Soviet decision to raise energy prices, however, disrupted East German planning. "Under no circumstances should we accept the price increases arising from speculative and other factors in the imperialist system because this would transfer the impact of capitalist inflation on our economic relations," a State Planning Commission report concluded.[42]

In East Berlin, Honecker convened a meeting in August 1974 with top economic officials to determine the East German response. Government estimates indicated that the increase in energy prices would hurt the East German balance of trade with the Soviet Union by about 7-8 billion marks in 1975, and 8-9 billion marks annually for the rest of the decade, figures that dwarfed the "expected increase in national income." State Planning Commission State Secretary Heinz Klopfer stressed that the East Germans needed to "fight hard" to reduce these price demands, pressing the Soviets at all levels of government. Rather than using 1973 and 1974 as base years for the new pricing system, Klopfer proposed extending the base period to five years. Using a floating pricing system for energy threatened to undermine the benefit of central planning. Mittag wondered what this precedent would do to do the pricing system within CMEA. "Planning without fixed prices is not possible," he lamented. "If we did not make any changes, that would mean an absolute decrease in the standard of living in the GDR." In conclusion, Honecker summarized that East German industrial production must continue and the contracts for 1975 must be completed regardless. "World market prices must not have an effect on the inner fabric of the GDR," he declared. The SED must secure the necessary national income,

[41] Gerhard Schürer to Erich Honecker, December 14, 1973, BAB, DE 1/58701.
[42] No author, "Standpunkt der DDR zur Gestaltung der RGW-Preise 1976-1980," May 30, 1974, BAB, DE 1/58577.

Honecker told his colleagues, “otherwise we might as well resign right now, and naturally we do not want that.”[43]

East German policymakers made these arguments to their Soviet counterparts at various levels of the government. At a meeting with Patolichev in November 1974, for example, East German Trade Minister Horst Sölle asked why world market prices should dictate changes in the CMEA. Inflation and currency crises were characteristics of an unstable capitalist system, Sölle told his Soviet counterpart, not of socialism. In CMEA, “there is a fundamentally different situation.” CMEA had a stable and transferrable currency – the ruble – so why should capitalist world market prices continue to serve as the basis for trade between socialist states? Patolichev replied that changes had to be made. The Soviet Union provided a portion of its material resources to the other economies of the bloc at lower prices than on the world market. “There is also the question,” Patolichev continued, “as to why the standard of living in the USSR must be lower than, say, Poland. It is not enough to say that the USSR bears the military burden or that it helps the developing countries….The USSR had accepted this situation long enough.” They both sought stable prices, but the use of 1973-1974 prices was unacceptable to the GDR, and 1970-1974 was unacceptable to the USSR. Therefore, Patolichev said, the Soviets would agree to a sliding scale as a compromise. Patolichev stressed that Moscow had a “genuine claim to charge realistic prices.” The Soviets “would have to get that to which they were entitled.” He also pointed out that it was “very surprising” that the other members of CMEA did not realize that they could only “master the effects of the crisis of the capitalist system only with the help of the Soviet Union.”[44]

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[43] Staatliche Plankommission Staatssekretär, “Persönliche Niederschrift über eine Beratung beim 1. Sekretär des Zentralkomitees der SED am 9.8.1974,” August 9, 1974, BAB, DE 1/58586.
[44] “Information über ein Gespräch mit dem Minister für Außenhandel der UdSSR, Genossen Patolitschew, am 11.11.1974,” November 11, 1974, SAMPO, DY 30/J IV 2/2J/5517.

At a meeting with Baibakov and Patolichev the following month in East Berlin, Honecker tried his hand. Baibakov reminded the East Germans that even though the Soviets raised the price of their oil, they still used a substantial proportion of their national income to benefit Eastern Europe. "This is a fact that one cannot simply dismiss," he said pointedly. Plus, Moscow did not demand world prices for its oil and asked for only 35 rubles per ton, while it sold for 56 rubles per ton or more in the non-socialist world. Patolichev tried to sympathize with the East Germans, saying "the current change in CMEA prices is the hardest job of my life." As the East Germans' benefactor and supplier of energy, the Soviet Union held the cards and prerogative to change prices as it wished. Honecker acknowledged defeat, noting that the other Eastern European countries had already agreed to the price hikes. "The basic decisions have already been made," he admitted. Frustrated nonetheless, the East German leader commented that both sides must remain vigilant in the battle against imperialism, but he stated that the price changes threatened East Germany's ability to do so. Fighting against imperialism "requires a certain standard of living," Honecker said. "The GDR has proven to be stable for 25 years and must prove to be so in the next 25 years." Taking a thinly veiled shot at Warsaw and Prague to highlight East Berlin's credentials as a loyal socialist state, Honecker added, "we had stability even in difficult times, in contrast to Poland and Czechoslovakia." Patolichev responded once again, with perhaps a patronizing undertone, "the current change in CMEA prices is the hardest job of my life."[45]

Soviet and East German policymakers estimated the total cost of the price increases at four to five billion rubles from 1976 to 1980. In order to pay for this, Soviet policymakers agreed to extend long-term credits at low interest rates. "What is necessary [for the GDR] will be

[45] "Niederschrift über die Beratung zwischen Genossen Erich Honecker und Genossen Baibakow am 21.12.1974," December 21, 1974, BAB, DE 1/58586.

credited," Baibakov promised Honecker. The two sides agreed that if the new prices created a deficit of three billion rubles, then the Soviets would extend a loan of 15 years. If the deficit totaled more than three billion rubles, Moscow would grant a 20-year loan.[46] The agreement that the Soviets reached with the East Germans matched compromises that Moscow made with other Eastern European capitals. Rather than introduce the new prices rapidly, the Soviets acquiesced to a less dramatic hike and agreed to use an average of the previous five years as the base price, rather than the three years that they had originally proposed.

While the Soviets had a collective trade deficit with the Eastern Europeans of 700 million rubles in 1973, the change in oil prices turned that deficit into a peak surplus of 1.4 billion rubles by 1977.[47] In 1974, the Soviets traded one million tons of oil for 800 Hungarian Ikarus buses, but by 1981, the oil cost 2,300 buses, and by the mid-1980s, 4,000 buses.[48] Fearing the deficits, the East Germans pressed the Soviets to honor the 14 rubles per ton price for the existing energy contract that was signed in April 1968. Deputy Foreign Trade Minister Vladimir Alkhimov refused and reminded the East German trade minister that his country was fortunate that the Soviets were honoring the contract at all. "If the USSR did not have such obligations," Alkhimov said, "it could release these quantities to sell on the free market at the current high world market prices."[49] The East Germans tried another tack, arguing that the price of their exports should increase to match the energy hikes. During negotiations in January 1976 on the adjustment of contract prices in trade between East Germany and the USSR, the East German Deputy Minister of Foreign Trade demanded that the increase in energy prices should be reflected in a higher

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[46] Gerhard Schürer, "Information zu Fragen der Korrektur der RGW-Vertragspreise mit der UdSSR und der Auswirkungen auf die Volkswirtschaft der DDR," undated (report of meetings with Soviet officials that occurred from December 21-23, 1974), BAB, DE 1/58569.
[47] Goldman, *The Enigma of Soviet Petroleum*, 103.
[48] Kotkin, *Uncivil Society*, 26.
[49] "Memorandum o besede zamestitelya Ministra tov. Alkhimova V.S. s zamestitelem Ministra vneshney torgovli GDR tov. Fenske, sostoyavsheysya 29 oktyabrya 1975 goda," RGAE, f. 413, op. 31, d. 7432.

price for East German exports such as chemical products. Alkhimov also dismissed this request, responding that the two sides should consider products independently.[50] After the USSR increased its energy prices, East Germany needed to export 20 percent more goods to the West to maintain its position in hard currency. “That’s not at all possible,” Honecker worried.[51]

As the most advanced industrialized socialist state in Eastern Europe, East Germany was particularly affected. The oil crisis and CMEA price increases, however, had debilitating effects on agricultural states in the bloc such as Bulgaria. At a meeting in June 1975 the Bulgarians and Soviets estimated a sizeable Bulgarian deficit of 3 billion rubles in bilateral trade, of which the Bulgarian State Planning Commission calculated 1.7 billion rubles could be attributed to the price increases. Kosygin indicated in June 1975 that the Soviets would extend loans to the Bulgarians to help cover this amount, but also indicated that Moscow expected Sofia to increase the volume of exports to cover the rest of the deficit.[52] The Bulgarians protested, demanding that they needed more oil, natural gas, and coal. Kosygin replied that the Soviets already were delivering significant amounts of oil and natural gas, and could not increase deliveries. In fact, progress in the Soviet energy industry was slowing, and that would likely lead to a “reduction in the quantities agreed so far.” As for more coal, Kosygin recommended, “talk to Poland.” [53]

In the fall of 1976, Bulgarian General Secretary Todor Zhivkov penned a long letter to Moscow to complain about the economic consequences in Sofia. The price increases may have been conceived to respond to the “great price dynamics” on the capitalist market and to help

[50] “Memorandum o vstreche Zam. Ministra vneshney torgovli SSSR tov. Alkhimova V.S. s Zam. Ministra vneshney torgovli GDR tov. Fenske K., sostoyavsheysya 29 yanvarya 1976 g. v MVT SSSR,” RGAE, f. 413, op. 31, d. 8236.
[51] Staatliche Plankommission Staatssekretär, “Persönliche Niederschrift über eine Beratung beim 1. Sekretär des Zentralkomitees der SED am 9.8.1974,” August 9, 1974, BAB, DE 1/58586.
[52] “Informatsiya za provedenata sreshta s drugarya Kosigin po otkritite vaprosi za sledvashtata petiletka,” June 11, 1975, Tsentralen darzhaven arhiv (TsDA), Sofia, Bulgaria, f. 130, op. 27C, a.e. 8.
[53] “Dopalnitelni belezhki ot provedenata na 4 yuni 1975 g. sreshta s dr. Kosigin,” June 11, 1975, TsDA, f. 130, op. 27C, a.e. 8.

coordinate CMEA planning, the Bulgarian leader began, but "we want to inform you that, in practice, this was not the case." Coordination between the Soviet and Bulgarian planning commissions in 1974 had envisioned an active Bulgarian balance of 1.5 billion rubles for the coming five-year plan from 1976-80. At the end of 1975, the Bulgarian deficit vis-à-vis the Soviet Union stood at 580 million rubles. As the price of goods continued to increase annually, preliminary Bulgarian estimates indicated that the debt would grow to 2.8 billion rubles by 1977. "There is a paradox," Zhivkov continued. Bulgarian "exports to the socialist countries, including the Soviet Union, are greatly increasing, and yet at the same time Bulgaria is becoming ever more indebted to them." The ramifications of the price increases "have shaken the entire planning of our development for the forthcoming period until the 1980s. I doubt our ability to cooperate with the Soviet Union and the other fraternal socialist states in planning for the social-economic development of the country because we do not have the resources that we had before the correction of contractual prices." When the growing debts to the capitalist world are included in Bulgarian calculations, Zhivkov worried, "you can imagine what the situation is now in our country."[54]

As an agricultural state with a limited industrial base, Zhivkov worried that Bulgaria would be particularly badly hit by the oil crisis. Bulgaria was the most southern state in the socialist community, and it was decided in the early years of CMEA that the country should specialize in agriculture. Zhivkov wrote, "This has created considerable tensions in our economy, holding back the development of other important industries." In the context of rising prices for fuel, machinery, and chemical products, this concentration on agriculture was becoming an even bigger disadvantage. Agricultural prices had not risen. "This is an

[54] Todor Zhivkov to Leonid Brezhnev and the CPSU Politburo, undated (likely fall 1976), TsDA, f. 378B, op. 1, a.e. 528.

overwhelming burden for us…we are at a dead end. We do not see an exit from the current situation." The Bulgarians had developed industries in mechanical engineering, metallurgy, energy, and chemical products (largely achieved with Soviet aid and equipment), but their exports were "quoted at low prices or not at all." Zhivkov pled with Moscow to change the balance between agriculture and industry in the country; otherwise, "Bulgaria will continue to develop with a deformed economic structure, an inefficient economy." The national income per capita in Bulgaria was lower than that of its peers within CMEA, and the changes in the conditions of trade in the socialist community "will inevitably lead to the continuation of this trend."[55]

The Bulgarians desperately wanted to join the ranks of heavily industrialized states. In his developmental plan for 1976-1990, State Planning Commission chairman Ivan Iliev outlined an ambitious path, including economic growth figures at 8 to 8.5 percent annually. These objectives "required deep and very substantial changes in the economic structure" of Bulgaria. "the most important in this respect is the increase in the share of national income generated by industry." Industrial production needed to increase by more than twenty percent in comparison to agricultural production. He envisioned that Bulgaria would take its place among the most advanced countries in the world, with the role of machinery and the chemical industry "totally comparable" to those in the West.[56] Iliev's plan, however, read more like a wish list rather than a serious model. If East Germany, the most advanced industrial state in the Eastern bloc, could not compete on the world market, then Sofia did not have much hope. As Zhivkov later wrote in his memoirs, "We had tremendous difficulties in the 1970s with regard to the transition to

[55] Ibid.
[56] Ivan Iliev to Todor Zhivkov, "Dokladna zapiska zapochvane rabotata pa plana za obshtestveno-ikonomicheskoto razvitie na stranata do 1990 godina," undated (1976), TsDA, f. 378B, op. 1, a.e. 1041.

international trade prices between the socialist countries. We have had a lasting struggle with this….Bulgaria was most affected. The sharp rise in prices of raw materials and equipment we imported could not be offset by our exports."[57]

The decision to move toward world market prices signaled the growing discontent in Soviet policymaking circles about bearing the growing costs of its informal empire in Eastern Europe. In an era of détente with the industrial democracies, Moscow began to reconsider the value of Eastern Europe to the Soviet Union. The 1975 energy hike represented a remarkable example of what Valerie Bunce calls "the empire strikes back" – the process of Eastern Europe transitioning from a Soviet asset to a liability. Moscow still continued to subsidize its trade within CMEA heavily; an estimate of the opportunity costs to the Soviet Union from CMEA trade valued the subsidy at $21.7 billion.[58] The Soviets' increasing willingness to start playing hardball with the Eastern Europeans, however, marked a turning point in the CMEA foreign trade structure. The oil crisis in the West pressured Moscow to make a choice between pursuing its own economic advantage or continuing to cushion its friends. Against vociferous protest from East Berlin, Sofia, and elsewhere, Moscow chose the former.

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Soviet energy became much more expensive for the Eastern Europeans in 1975, but importing from the Soviet Union was still cheaper than purchasing oil directly from OPEC or on the Rotterdam spot market. Not only did world market prices far exceed Soviet prices – even at the new latter's price point – but the Soviets also accepted inferior Eastern European goods as payment. In contrast, the Eastern Europeans had to spend valuable hard currency to purchase oil

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[57] Zhivkov, *Memoari*, 511.
[58] Valerie Bunce, "The Empire Strikes Back: The Evolution of the Eastern Bloc From a Soviet Asset to a Soviet Liability," *International Organization*, Vol. 39, No. 1 (Winter 1985), 15

from the Middle East. The 1973 oil crisis and relatively slow development of Soviet reserves meant that the Eastern Europeans confronted multi-layered supply and cost problems. Soviet deliveries of energy did not keep pace with demand, and the Eastern Europeans increasingly had to make up the difference though imports from OPEC, paying non-subsidized world market prices. As a result, the Eastern Europeans made obtaining as much energy as possible from Moscow a top priority in foreign trade.

Socialist policymakers continuously debated a fundamental question about the role of the socialist state: should it satisfy its citizens' material needs, or impose moral and ideological discipline? By the 1970s, the answer of many Eastern European policymakers shifted toward the former. The specter of West German revanchism lost much of its strength as a unifying device after the *Ostpolitik* initiatives of West German Chancellor Willy Brandt, the Treaties of Moscow and Warsaw, and the Basic Treaty. Socialist states now generally turned to consumerism as a source of legitimacy, promising higher standards of living and social services. The British Treasury observed that in Hungary, the "debate progressed from 'Goulash' socialism via 'refrigerator' and 'car' socialism to 'weekend house' and 'journey to the west' socialism."[59] At the SED's Eighth Party Congress in June 1971, the East Germans committed themselves to supporting a consumer society, initiating a program to subsidize further consumer prices, vacations, and housing, and also introduced systems of day care, child support and maternity.[60]

The evolution in Eastern European socialism made the system particularly vulnerable to fluctuations in the energy market. Imported hydrocarbons fueled East Germany's primary industries, which produced the goods that East Berlin traded to the non-socialist world in exchange for convertible currency. As energy prices rose, so too did production costs. "The

[59] J.R. Nichols, "Hungary: The Second Economy," August 19, 1981, UKNA, T 439/23.
[60] Kopstein, *The Politics of Decline in East Germany, 1945-1989*, 81.

import price increases for raw materials on this scale represent a significant increase in the cost of all stages of production in the GDR," an East German State Planning Commission report observed in August 1974.[61] A decline in living standards as a result of energy shortages threatened popular unrest. Eastern Europeans borrowed heavily to finance this turn to consumerism, and debt to Western banks skyrocketed during the 1970s. They could not afford to pay for additional energy from OPEC at world market prices, but they had no other choice.

Eastern European leaders viewed securing energy as an issue that threatened their regimes. As Honecker warned Soviet policymakers, "the energy question is an existential question for the GDR." East German Council of Ministers chairman Willi Stoph added that without enough energy, "we cannot guarantee the basic political principles for the development of our republic."[62] In January 1974, the Soviet shortfalls on energy deliveries forced East Berlin to purchase almost a million tons of oil on the spot market at a price of about $80 per ton rather than the $16 per ton that they had paid just the previous year (Baibakov shared that the Soviets themselves had to import 12 million tons of oil from Iraq).[63] The East Germans received 80-85 percent of their oil from the Soviet Union, but that still left 15-20 percent that they had to buy abroad, at prices that had more than quadrupled after the 1973 oil crisis, and would continue to climb higher.[64] The Bulgarians anticipated in November 1974 that they would have oil shortages for the rest of the decade, ranging from 1.5 million tons in 1976 to 3.5 million tons in 1980.

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[61] Staatliche Plankommission, "Erste volkswirtschaftliche Einschätzung der für 1975 angekündigten Veränderung von RGW-Vertragspreisen im Handel mit der UdSSR," August 12, 1974, BAB, DE 1/58586.
[62] "Stenografische Niederschrift der Beratung des Vorsitzenden des Ministerrates der DDR, Genossen Willi Stoph, mit dem Vorsitzenden des Ministerrates der UdSSR, Genossen Alexej Kossygin, am Freitag, dem 8 December 1978, in Moskau," BAB, DE 1/58666.
[63] "Information über das Gespräch des Genossen Erich Honecker mit Genossen Nikolai Baibakow," January 2, 1974, BAB, DE 1/58584.
[64] Staatliche Plankommission, Abteilung Leitungsorganisation, "Zusammengefasste Übersicht der dem Vorsitzenden der SPK von den Bereichen und Abteilungen unterbreiteten Vorschläge für 'höhere Effektivität und Konsequente Intensivierung' in Auswertung der 13. Tagung des ZK der SED," February 2, 1975, BAB, DE 1/55682.

The Bulgarian State Planning Commission estimated that purchasing the additional oil on the world market over this period would cost an additional 1.2 billion leva in convertible currency–and even this calculation supposed a fixed oil price, an assumption that proved gravely mistaken.[65] "The development of our country's economy is related to the rapid increase in the demand for energy," a Bulgarian report concluded in November 1974. The Soviet Union promised to increase its deliveries of oil to 12.5 million tons by 1980, but the State Planning Commission nevertheless expected that Bulgaria's oil needs would require Sofia to purchase an additional 3.5-5.5 million tons on the world market at a cost of somewhere between $300 and $500 million. "This is a very high figure for our country." In 1990, Sofia feared that its oil demand would rise to 22-25 million tons annually, forcing it to purchase 10-12 million tons on the world market at a cost of $1 billion.[66] "In the current global energy crisis," Iliev told Baibakov, the Bulgarian State Planning Commission "had to implement a maximum reduction of the total energy consumption as well as importing energy, particularly from the USSR." Because of the shortages in Soviet deliveries, however, the Bulgarians had to turn to the Arab countries. In its current state, the Bulgarians could not purchase more than 4-500,000 tons. Iliev requested that Baibakov do everything he could to increase oil exports to Sofia, but Baibakov refused, saying that the Soviets had their own difficulties.[67]

Baibakov was right. The reality was that the Soviet energy industry could not meet the growing demand in Eastern Europe. The Soviet Union had its own economic woes to manage, and an increasing amount of oil and natural gas was sent to Western Europe to pay for badly

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[65] "Saobrazheniya za vtorata svodna konsultatsiya mezhdu tsentralnite planovi oprani na NRB i SSSR / 27 noembri 1974 godina," November 12, 1974, TsDA, f. 130, op. 26C, a.e. 20.
[66] "Saobrazheniya po razshiryavane na satrudnichestvoto mezhdu NRB i SSSR i na na mnogostranna osnova v oblastta na nefta i prirodniya gaz," August 26, 1974, TsDA, f. 130, op. 26C, a.e. 20.
[67] Georgi Georgiev, "Spravka za razgovorite mezhdu dr. N.K. Baibakov i dr. Iv. Iliev po nyakoi vaprosi na koordinitsiyata na planovete za perioda 1976-1980 g. sastoyali se na 1 i 2 avgust 1974 g. v Moskva," August 5, 1974, TsDA, f. 130, op. 26C, a.e. 20.

needed grain and other goods. Even the Soviet Union itself suffered from energy shortages. In January 1974, Baibakov admitted to Honecker that the government had to shut down schools in Kiev because they could not heat the classrooms. The lack of gas forced plants and factories across the Soviet Union to revert to coal. If the country had to endure severe cold weather in the coming winter months, Baibakov worried, agricultural production would certainly be interrupted. “We are not in a crisis situation, but there is that possibility,” he said.[68]

The Soviet energy industry was not working as efficiently as it needed to be. The Soviets’ total energy production increased in the 1970s as the center of the industry shifted from the European regions of the country to Siberia. While the Soviets produced just over 500 million tons of oil in 1970, that figure rose to more than 850 million tons by 1980.[69] Soviet leaders sacrificed efficiency for speed, however, and operated at a “breakneck” pace to produce as much energy as possible, as quickly as possible.[70] Moscow’s inability to cover CMEA’s needs stemmed from technical and transportation problems that continued to plague the Soviet energy industry. The country had the resources to cover Eastern European demand, but they lacked the means to extract them efficiently and transport them to consumers far to the west. In 1974, for example, the Soviets planned to produce over 450 million tons of oil, but Oil Minister Valentin Shashin reported that only 11 of the 26 oil-producing areas in the country could meet their quotas.[71] Officials criticized the slow progress in developing the valuable reserves in western Siberia.[72] Transportation seemed an intractable problem. Vladimir Inozemtsev said, “There is

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[68] “Information über das Gespräch des Genossen Erich Honecker mit Genossen Nikolai Baibakow,” January 2, 1974, BAB, DE 1/58584.
[69] CIA Directorate of Intelligence, *Soviet Energy Data Resource Handbook*, May 1990, 3.
[70] Arbatov, *The System*, 216.
[71] This figure comes from an article that Shashin authored that appeared in the journal *Sotsialisticheskaya Industria* on 6 June 1974. An English summary of the article’s major conclusions can be found in F.W. Willis to C.J.R. Meyer, “Soviet Oil Production,” June 11, 1974, UKNA, FCO 28/2610.
[72] See, for example, “Partiynaya zhizn’ informatsiya,” *Pravda* (Moscow), November 23, 1973, 2.

always the issue about what is the most economical and rational solution to fuel and energy problems for the socialist countries as a group and as individuals…in Gosplan, nobody knows how to proceed. Currently analysts say that a growth in oil exports is not possible.[73] Baibakov estimated that the cost of producing one ton of oil would rise to 120 rubles, in comparison to the 95 rubles that it required in 1973.[74] "To develop new reserves is not as easy as it seemed to us earlier," Brezhnev conceded to a group of Eastern European leaders in March 1975.[75]

The Soviets understood the threat that the energy crisis posed to their allies in Eastern Europe. "This is a question of life or death," Baibakov said in January 1974. "The crisis on the capitalist market will intensify and prices will continue to climb. This will have severe economic and political ramifications."[76] Requests for increased energy deliveries became permanent fixtures on the agenda during East German consultations with Soviet leaders, and the Soviets constantly informed their East German interlocutors that it was impossible. "It is not that we don't want to increase production," Kosygin told Stoph, but the expenses were enormous, and the transportation of energy across thousands of kilometers was "not economical."[77] The tone of these conversations sometimes became contentious, as the Soviets accused the East Germans of being unrealistic and ungrateful for Moscow's subsidies.

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[73] "Niederschrift über die Beratungen mit Genossen Inosemzew zu Hauptfragen der ökonomischen Beziehungen zwischen der DDR und der UdSSR für den Zeitraum nach 1980," July 16, 1976, SAMPO, DY 3032/1529.
[74] Gerhard Schürer, "Information über die Beratungen zwischen Genossen Schürer und Genossen Baibakow über Grundfragen der Rohstofflieferungen der UdSSR in die DDR im Zeitraum 1976-1980 am 21.5.1973," May 5, 1973, BAB, DE 1/58507.
[75] "Record of Conversation of Brezhnev with Leaders of Fraternal Parties of Socialist Countries," March 18, 1975, History and Public Policy Program Digital Archive, US Library of Congress, Manuscript Division. Dmitrii A. Volkogonov Papers, Reel 16, Container 24. Translated by Svetlana Savranskaya for the National Security Archive.
[76] Ibid.
[77] "Niederschrift über die Verhandlungen zwischen dem Vorsitzenden des Ministerrates der DDR, Genossen Willi Stoph, und dem Vorsitzenden des Ministerrates der UdSSR, Genossen A.N. Kossygin, am 10.12.1976 in Moskau," December 12, 1976, SAMPO, DY 3023/1529.

The supply of energy became central points of contention between Moscow and its Eastern European allies for the rest of the decade. A particularly antagonistic meeting that illuminated the looming economic crisis occurred in December 1976 between Kosygin and Stoph. The East German had come to Moscow to negotiate an increase in Soviet energy deliveries, but the conversation quickly expanded to include a host of other issues. Worried about the East German balance of payments, Kosygin asked about the East German trade deficit. Stoph indicated that it surpassed the national income. Taken aback, Kosygin said, "that means that the internal debt of the DDR is large, it is 2.5 times per person as high as in the USSR, but the internal debt is better than the foreign. That means that you must try to use the domestic deficit to reduce the foreign deficit." Stoph quipped: "Give us a prescription, then." Kosygin shot back, "We could give you one, but would you follow it?" Stoph told Kosygin in 1976 that the greatest problems in economic planning in the GDR were bad harvests and the deficit in the balance of payments with the non-socialist countries, including the growing debt and increasing interest payments on that debt. He said that the goal of the GDR was to increase its exports to the non-socialist world (NSW – *nichtsozialistisches Wirtschaftsgebiet*) by 18 percent. Kosygin feared that the GDR was directing all of its resources toward rectifying the balance of payments deficit with the NSW, and asked whether this growth in exports meant "that everything will be shipped to the NSW, and then nothing will be left for your socialist brothers?"[78] Baibakov added that the East Germans had a shortage of 60 million rubles worth of exports to the Soviet Union, a trade deficit that "came not just from the price increases."

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[78] Kosygin's castigation notwithstanding, Soviet foreign trade followed a similar trajectory. Official Soviet trade statistics indicate that Moscow's trade with socialist countries dropped from 58.5 percent in 1973 to 54.1 percent in 1974, for example, while trade with the industrial democracies rose from 26.6 percent to 31.3 percent during the same interval. See Ministerstvo vneshniei torgovlii SSSR, *Vneshniaia torgovlia SSSR za 1974 god: statisticheskii obzor* (Moskva: Mezhdunarodnie otnosheniia, 1975), 19.

The conversation then shifted to energy. Stoph pressed Kosygin to increase the Soviet delivery of oil to East Germany, requesting an additional two million tons of oil and one billion cubic meters of natural gas. “We do not use natural gas in households,” Stoph argued, “but rather for use in the chemical industry or as process energy.” Kosygin, with a touch of aggravation, told Stoph that such increases were not possible. Ten years prior, the Russian said, the Soviet Union delivered 3.3 million tons of oil to East Germany. In 1970, that number climbed to 9.28 million tons and would reach 19 million tons by 1980. “That is a very favorable development for the GDR,” he said. Pointing to the privileged position of East Germany, Kosygin noted that “oil is very economical for you. All you have to do is turn on the tap.” The Soviets, who actually had to produce energy, however, had significant difficulties expanding their industry, and yet they managed to live up to their commitments within CMEA. They would continue to do so, but “an increase is not possible. The expenses, especially for transportation, are huge. It is not that we do not want to, but rather transporting natural gas over 4,000 km is uneconomical.” “You must get your head out of the clouds,” Kosygin told Stoph. “My head is not in the clouds,” Stoph retorted. “But you want us to increase our deliveries,” Kosyin shot back. “We cannot meet such demand. Nobody in the world can.”

As the meeting came to an unsatisfactory end for Stoph, Kosygin tried to lighten the atmosphere. Kosygin acknowledged that the Soviets “understood that your situation is not easy.” Boasting about the superiority of central planning, he told his that

> the situation of the socialist countries is a thousand times better than in the capitalist world. All deliveries of raw materials are clear for us for five years….But in capitalism nobody can foresee three months. We, in contrast, have a full developmental program for five years, which also provides security for raw materials.

The socialist bloc had its economic problems, but at least it was not capitalism.[79] This final point, however, did not overshadow the main theme of the conversation between Kosygin and Stoph: the troubling connection between problems in the Soviet energy industry and the vitality of Eastern European socialist regimes.

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Similar to Western solutions to its growing dependence on the global South for raw materials, the members of CEMA planned to overcome their emerging crisis by increasing national production and deepening inter-alliance cooperation. First, the Soviets emphasized that the Eastern Europeans needed to take a greater role in the production of Soviet energy, particularly natural gas. An increase in natural gas and oil deliveries "can only happen with the direct participation of the 'socialist countries concerned,'" Soviet officials told Bulgarian leaders in July 1973.[80] The issue was never that the Soviets did not have enough energy; they had some of the largest oil and natural gas reserves in the world. "The main problem," Baibakov said, "is transporting such huge quantities over significant distances." Soviet planners considered transporting natural gas in liquid form, a tactic that would reduce the necessary and very costly pipelines from ten to three. The price of tubes rose quickly in the mid 1970s on the world market, and Moscow pressed its Eastern European allies to play a more active role in the construction of the Soviet energy infrastructure.[81] "Because there is at the moment no other way to cover the growing oil and natural gas needs in the GDR after 1975," Schürer wrote Honecker in April

[79] "Niederschrift über die Verhandlungen zwischen dem Vorsitzenden des Ministerrates der DDR, Genossen Willi Stoph, und dem Vorsitzenden des Ministerrates der UdSSR, Genossen A.N. Kossygin, am 10.12.1976 in Moskau," December 13, 1976, SAMPO, DY 3023/1529.
[80] Georgi Georgiev, Tsvetan Tsenkov, and Boris Boev to Ivan Iliev, "Dokladna zapiska: Rezultatite ot konsultatsiyata na spetsialisti na tsentralnite planovi organi na NRB i SSSR po svodnite vaprosi na ikonimicheskoto catrudnichestvo prez 1976-1980 g.," July 13, 1973, TsDA, f. 130, op. 25C, a.e. 9.
[81] "Information über das Gespräch des Genossen Erich Honecker mit Genossen Nikolai Baibakow," January 2, 1974, BAB, DE 1/58584.

1973, "we must take this suggestion very seriously."[82] In 1972 and 1973, the CMEA Commission for Oil and Gas decided to construct a unified system of pipelines to transport natural gas to consumers in Eastern Europe as well as new consumers in Western Europe.[83]

The Soviet Union and its Eastern European allies (excluding Romania) agreed in June 1974 to develop the massive Orenburg field in Russia and transport natural gas by pipeline to Eastern Europe. The reserve was located 30 km to the west of Orenburg, spanning 3,000 square km. The Soviet Reserves Committee believed that reserves totaled 1.66 trillion cubic meters and that the field could yield about 60 billion cubic meters annually.[84] Each of the Eastern European countries took responsibility for constructing a part of the pipeline – known as Soyuz ("Union"). The Soviets estimated that the pipeline would run 2,750 kilometers from Orenburg to Uzhgorod, transporting 15 billion cubic meters of gas annually to consumers in Eastern Europe. After the completion of the project, ownership of the pipeline transferred to Moscow and the Eastern Europeans received energy compensation – when work finished in 1978, each country received 2.8 billion cubic meters per year as the tap turned on in January 1979. The Soviets estimated the total cost of the project at 3.6 billion rubles, more than half of which would be borne by Moscow.[85] The Soyuz pipeline initiated "a qualitatively new stage in the cooperation of the socialist countries" in the energy sector, an Oil and Gas Industry official boasted to *Pravda* correspondents in November 1975.[86] As the energy scholar Per Högselius notes, the Soyuz

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[82] Gerhard Schürer to Erich Honecker, April 27, 1973, BAB DE 1/58578.
[83] Sovet ekonomicheskoy vzaimopomoshchi: postoyannaya komissiya po neftyanoy i gazovoy promyshlennosti, "Protokol sorokovogo pervogo zasedaniya," December 1974, RGAE, f. 302, op. 2, f. 1191.
[84] N. Kornienko, "Spravka ob Orenbureskom gazokondensatnom mestorozhdenii i protekal magistral'nogo gazoprovoda Orenburg - Zapadnya granitsa SSSR," October 23, 1973, RGAE, f. 302, op. 2, d. 1063.
[85] "Informatsiya delegatsii SSSR o khode podgotovki General'nogo Soglasheniya po stroitel'stvu magistral'nogo gazoprovoda iz rayona Orenburga do zapadnoy graniyts SSSR," included in Sovet ekonomicheskoy vzaimopomoshchi: postoyannaya komissiya po neftyanoy i gazovoy promyshlennosti, "Protokol sorokovogo zasedaniya," May 1974, RGAE, f. 302, op. 2, f. 1190. See also Högselius, *Red Gas*, 171-72.
[86] November 3, 1975, *Pravda*, 2.06.107, 1748

pipeline became a "showpiece" of CMEA integration. With reserves amounting to about 40 percent of the world's total, the Soviet Union surpassed the United States in 1984 as the largest natural gas producer. Successes in developing the Soviet natural gas industry caused Brezhnev to launch a crash natural gas campaign in 1981 to counter the myriad problems with the oil industry, envisioning a future dependent on natural gas and nuclear energy.[87]

The Soyuz pipeline was a remarkable achievement, but it did not come without costs. Moscow leaned on Western Europeans firms in the early 1970s to help develop the Soviet energy industry, and those companies had the technology and know-how to master the challenges that western Siberia faced. The Eastern Europeans, in contrast, did not. Iliev, for example, warned Council of Ministers Chairman Stanko Todorov that the successful completion of Bulgaria's share of the project "would pose extremely large challenges for our country." Aside from paying the up-front costs in convertible currency, Sofia would need to provide 6,000 skilled workers to build the Bulgarian section of the pipeline over two to two-and-a-half years. "Removing this workforce from our sites in Bulgaria for a long period of time, with our limited labor resources, would lead to difficulties in the implementation of our annual plans." Furthermore, the Bulgarians did not have the expertise to accomplish some of the challenges associated with the project. "Our country has no experience in crossing major water barriers and performing similar tasks," Iliev worried. He feared that the Bulgarians would likely have to turn to Soviet subcontractors to overcome such obstacles.[88]

Furthermore, inflation in the capitalist world meant that the project cost each participant much more than had been estimated in 1974. Some officials had seen this coming. The Bulgarian Finance Minister Dimitar Petrov Popov wrote in October 1973 that unfixed prices in the

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[87] Gustafson, *Crisis Amid Plenty*, 137.
[88] Ivan Iliev to Stanko Todorov, October 10, 1973, TsDA, f. 130, op. 25C, a.e. 10.

agreement worked to Sofia's disadvantage. Popov noted that the Bulgarians would have to import machines, equipment, tubes, and other materials from the non-socialist world and pay for them in convertible currency. Because of the rampant inflation in the capitalist world, "we cannot accurately judge the cost of the project to our country." The payment structure also put the Eastern Europeans at a disadvantage. The Bulgarians would complete their share of the pipeline by the end of 1976, Popov noted, and their credit for natural gas imports would be defined with those prices. Deliveries of natural gas would continue for more than a decade, however, and Sofia would have to pay contractual prices in effect at the time of delivery. Thus, the Bulgarians and others would get less natural gas than they would have if the agreement had fixed prices.[89]

The Soviets had initially estimated that it would cost East Germany 340 million rubles to complete its share, but skyrocketing inflation increased the cost of the equipment by 91 million rubles just two years later. When the project began, the Soviets sold natural gas within CMEA for just over 14 rubles per cubic kilometer. According to the resolutions of the 70th session of the Executive Committee of CMEA, natural gas from the Orenburg reserve would be subjected to the same price increases as elsewhere. Thus, when the pipeline became fully operational in 1980, the Eastern Europeans paid about 48 rubles per cubic kilometer, an increase of almost 350 percent in comparison to the 14 rubles per cubic kilometer to which the parties had agreed in 1974.[90] In the spring of 1986, the ministers of trade and bankers from Bulgaria, Hungary, East Germany, Poland, the USSR, and Czechoslovakia to evaluate the total cost of the project in convertible currency. In sum, the countries spent roughly $1.75 billion with each country

[89] Dimitar Petrov Popov to Ivan Iliev, October 6, 1973, TsDA, f. 130, op. 25C, a.e. 10.
[90] Wolfgang Rauchfluß and Harry Bernstein, "Zu ökonomischen Problemen bei der Realiserung der Erdgasleitung Orenburg-Westgrenze UdSSR und der damit verbundenen Erdgaslieferungen aus der UdSSR," 4 May 1977, SAMPO, DY 30/25763.

contributing between approximately $290 million (Bulgaria) and almost $400 million (Czechoslovakia).[91]

Furthermore, the increase in natural gas exports from the Soyuz pipeline to Eastern Europe, failed to make a crucial difference. It coincided with the decline of production in the other parts of the Soviet Union. The combined production from the country's other major gas fields in the European regions peaked in 1976, and began to decline in 1977.[92]

The second option that the Soviets suggested was to explore the use of alternative sources of energy, particularly nuclear. Coal still provided about 60 percent of total energy use in the Eastern bloc by 1980, but economic planners sought to switch to oil and natural gas for the most important industries, particularly chemical and metallurgical. Furthermore, coal output in the European regions of the USSR stagnated, reaching a plateau of two percent growth per year in the 1960s and 1970s. The Soviet Union had enormous untapped reserves of coal in Siberia, but coal production suffered from the same challenges that afflicted the production of natural gas and oil. Shortages of railcars for transportation and poor utilization of labor created bottlenecks that delayed the opening of new mines.[93] Nuclear energy was a preferred long-term solution and had several advantages over fossil fuels. In contrast to oil, natural gas, and coal, nuclear energy did not have the locational restrictions that hindered the development of Soviet resources in unforgiving climates. Nuclear power stations could be established in the industrial heartlands of the Soviet Union and Eastern Europe. By 1978, the number of stations reached 28 in the Eastern bloc (21 in the Soviet Union alone) and produced just over ten percent of the world's nuclear

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[91] "Protokoll über die Abstimmung der endgültigen Höhe der Aufwendungen in frei kovertierbarer Währung für den Bau der Gasleitung 'Sojus,'" undated (included as an attachment to letter dated May 8, 1986), BAB, DN 10/1159. The figures correspond to the total amount of credits that the participating countries received from the International Investment Bank in Moscow.
[92] "Communist Countries in the Oil Market," September 14, 1978, CREST.
[93] CIA paper, "Communist Countries in the Oil Market," 14 September 1978, CREST.

energy.[94] Increasing nuclear power output became a top priority for every Eastern European country, but analysts did not expect it to make a significant contribution to consumption until the late 1980s, and even then it was only expected to contribute between five and ten percent of the total.[95] It therefore could not help solve the problem at hand or resolve the corresponding political dangers.

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The rising price of energy, both within and without CMEA, was the most dramatic expression of an inflationary trend in the global commodities markets. Factors such as the devaluation of the U.S. dollar in the early 1970s and the desire of newly independent countries in the global South to seize control of their resources contributed to rises in prices for a range of raw materials. Emboldened by the success of OPEC's embargo and production cuts in 1973-1974, the members of the global South demanded the establishment of a North-South dialogue to negotiate a more equitable share of global wealth. The socialist bloc encouraged the developing world in its insurgency against the industrial democracies, celebrating this expression of anti-colonial strength against their former oppressors.

Although the socialists refused to take part in the North-South dialogue (the exception was Romania, which participated as a member of the G77), they still felt the impact of the rising prices of commodities besides energy on the world market.[96] With its vast reserves, the Soviet Union enjoyed higher prices for its energy exports (with a high opportunity cost, as noted above). As a major exporter of sugar, Cuba also took advantage of the higher prices. The other

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[94] R.S. Mathieson, "Nuclear Power in the Soviet Bloc," *Annals of the Association of American Geographers*, vol. 70, no. 2 (June 1980), 271-79.
[95] Hoffman, "Energy Dependence and Policy Options in Eastern Europe," 664.
[96] "Romania is still a developing country," Romanian Prime Minister Ion Gheorghe Maurer wrote Willy Brandt in May 1972. Ion Gheorghe Maurer to Willy Brandt, May 31, 1972, Archiv der sozialen Demokratie der Friedrich-Ebert Stiftung, Bonn, Germany, Willy Brandt Archiv, A8/58.

members of CMEA, however, had limited domestic reserves of raw materials and suffered from inflation on the global market. "The inflationary developments on prices in the capitalist world means that we must allow for much higher sums to be spent to procure our country's needs," Schürer wrote in November 1973. Schürer estimated that the rise in the price of raw materials on the world market would cost East Germany about DM 1 billion in 1974 just to maintain its position from the previous year.[97] Reflecting on the disruptions that inflation in the capitalist world inflicted in the socialist bloc, East German Minister of Foreign and Inter-German Trade Horst Sölle in July 1974 wondered how the socialists could shelter their economies from the higher prices. In reply, Soviet Deputy Minister of Foreign Trade Mikhail Kuzmin advised Sölle that insulating the socialist bloc was impossible. "All thoughts in this direction are misguided," Kuzmin said gravely. "A reversal of prices on the world market will not occur," he concluded. The socialist bloc simply needed to adapt to these new conditions.[98]

Imports of coffee provided an example of how a change in the political economy of commodities in the global South affected the internal affairs of the Eastern bloc. In comparison to 1975, prices for coffee had increased 250 percent and cocoa 400 percent by the summer of 1977. The GDR Council of Ministers reported that if the regime imported coffee and cocoa in the amounts that it had intended, it would have to spend the "enormous sum" of VM 3 billion. To compensate for the new expense, other sectors of the economy would suffer. "It is not possible," the Council of Ministers concluded.[99] These price increases had a significant effect on East German imports. For the first four months of 1977, the GDR planned to import 52 tons of coffee

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[97] Gerhard Schürer, "Gegenwärtiger Stand und Probleme der Ausarbeitung des Volkswirtschaftsplanes 1974," November 7, 1973, BAB, DE 1/58701.
[98] Werner Jarowinsky to Erich Honecker, "Niederschrift über die Beratung des Ministers für Außenhandel der DDR, Genossen Sölle, mit dem amtierenden Minister für Außenhandel der UdSSR, Genossen Kusmin, am 2.7.1974," July 3, 1974, SAMPO, DY 30/8934.
[99] "Zur weiteren Versorgung der Bevölkerung der DDR mit Kaffee und Kakaoerzeugnissen unter den Bedingungen außerordentlicher Preissteigerungen auf dem Weltmarkt," undated, SAMPO, DY 3023/1218.

for VM 232 million. The price increase on the world market, however, forced East Berlin to spend VM 484 million for only 34 tons. "Further coffee imports for the year 1977 are not possible. The unused quantities are to be withheld and used in the second half of 1977."[100]

The rising price of coffee posed a familiar problem. How should East Germany satisfy consumers while remaining solvent in the face of rising world commodity prices? When an official suggested that East Berlin introduce rationing or simply explain the problem to the people and raise the price of coffee, Honecker refused to consider it. "We cannot have a 100 percent price increase," he said. If the price of coffee rose, Honecker feared that the public would link that change to other price increases across the economy. "Others have already tried that," he noted, and worried that it would lead to "general restlessness" among the East German public.[101] Recalling the Ersatzkaffee improvisations during the Second World War, the regime introduced an alternative called "Kaffee-Mix," which was a mixture of 51 percent real coffee and 49 percent grain. Krolikowski warned, "If we offer a coffee blend, then we have to make it so that people say that it is good."[102] The public decided that it was not, and reaction against Kaffee-Mix was swift. East Germans dubbed it "Erich's Krönung" – a play on the West German coffee brand Jacobs Krönung. The regime received so many complaints that East Berlin was forced to increase coffee imports. As Steiner has written, "What the 'coffee crisis' revealed was a vicious circle of rising world market prices, supply disruptions and loyalty losses – a vicious circle from which the party was unable to escape right up to its end."[103]

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[100] "Konzeption zur Durchsetzung der Einsparung von Valutamitteln beim Import von Rohkaffee," April 18, 1977, SAMPO, DY 3023/1218.
[101] "Zu Kaffee und Kakao (Beratung am 2.6.1977)," June 2, 1977, BAB, DE 1/58632.
[102] "Niederschrift zur Beratung des Entwurfs der staatlichen Aufgaben 1978 und Massnahmen zur weiteren Durchführung des Volkswirtschaftsplanes 1977 im Politbüro am 28.6.1977," June 28, 1977, BAB, DE 1/58618.
[103] Steiner, *The Plans That Failed*, 159. Anne Dietrich, "Kaffee in der DDR – "Ein Politikum ersten Ranges," in *Kaffeewelten: historische Perspektiven auf eine globale Ware im 20. Jahrhundert*, ed. by Christiane Berth, Dorothee Wierling, and Volker Wünderich (Göttingen: V&R Unipress, 2015).

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As commodity prices rose, socialist deficits with the non-socialist world (NSW) ballooned. While deficits within the socialist bloc could be handled internally deficits with the NSW could not. For the Eastern Europeans to remain solvent, they needed capital from Western. East German policymakers, for example, understood that they had become dependent on Western finance to satisfy their central planning objectives.

In an analysis of East Germany's project balance of payments for the rest of the decade, Central Committee department head of planning and finance Günter Ehrensperger identified significant dangers ahead. He knew that the country needed to "improve the material and cultural living standards of the people," but he also understood that this fundamental objective came into conflict with the necessity "to secure the solvency of the GDR in relation to capitalist countries." "The decisive question for the balance of payments in the period 1976-80," Ehrensperger wrote, "is being able to secure the necessary hard currency and thus the liquidity of the DDR in convertible foreign exchange." Ehrensperger calculated that the need rested at VM 2.2 billion in 1975, and would climb to VM 3.5 billion in 1976, VM 4.6 billion in 1977, and VM 5 billion by the end of the decade. This would increase the East German liability to the non-socialist world from VM 14.3 billion in 1975 to VM 19.2 billion in 1980. The interest on loans already grew rapidly. In 1971, East Germany paid about 5 percent of its export earnings to cover interest, but by 1975, that figure rose to 13 percent. Ehrensperger estimated that the cost alone of servicing the interest on Western loans would amount to VM 7.7 billion from 1976-1980, a number that surpassed the value of East German exports to the non-socialist world in 1975. To make matters worse, Ehrensperger pointed out, the Deutsche Außenhandelsbank managed to secure predominantly short-term loans that needed to be repaid quickly.[104] Furthermore, the East German debt with the Western world, unlike the Polish, for example, was spread among a consortium of several hundred banks, meaning that restructuring the debt would be extraordinarily difficult.[105]

As long as East Germany could rely on a stream of capital from consortia of Western banks, the country could delay making domestic adjustments to bring down its debt. Ehrensperger acknowledged the fact, however, that the tap could soon turn off. He warned, "Inevitably, the time will come when the GDR will not have the necessary cash in convertible currency to meet its external economic obligations, which would trigger an intrusion into the internal balance sheets and a chain reaction that would cause great political and economic damage."[106]

Fortunately for East Berlin, Western banks in the mid 1970s proved willing to extend loans. After the oil crisis, the capitalist world slipped into recession and credit opportunities were limited. Banks were anxious to limit their exposure to risk, particularly in the aftermath Herstatt's bankruptcy in June 1974. "The business operations of the Aussenhandelsbank on the capitalist money markets has become much more difficult. Practically no new deposits were accepted by small and medium capitalist banks," the President of the Staatsbank Horst Kaminsky reported.[107] As OPEC funds recycled back into the Western financial system in 1974 and 1975,

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[104] In 1976, for example, almost three-quarters of the loans from the NSW needed to be repaid within two years. See "Fälligkeiten der kommerziellen und Bankverbindlichkeiten gegenüber dem NSW nach dem Stand vom 31.12.1976," undated, BAB, DN 10/3454.
[105] Günter Ehrensperger to Werner Krolikowski, "Material zu Fragen der Zahlungsbilanz im NSW," September 23, 1975, SAMPO, DY 30/25762.
[106] Ibid.
[107] Horst Kaminsky, "Zur gegenwärtigen Entwicklung der kapitalistischen Währungskrise," July 16, 1974, BAB, DN 10/463.

however, the situation changed. Flush with petrodollars from the oil producers in the Middle East, Western banks had money to burn.

They increasingly worried about the growing Eastern European deficits. During a trip to the United States in the fall of 1976 to raise more funds to finance grain imports, East German financial officials in the Deutsche Außenhandelsbank met with 31 U.S. banks, including Citibank, Chase Manhattan, Bank of America, and Wells Fargo. "The trip came at an advantageous time for us," the report stated, "because U.S. banks are currently in a favorable liquidity situation on account of the unexpectedly low demand of large U.S. firms for loans." The banks warned "very openly," however, that this would change as soon as demand in their own country rose again.[108] Many indicated that they were interested primarily financing imports from their own countries[109]

Although the East Germans received loans, Western banks became increasingly uneasy with the fact that they did not release information about the size of the debts. "In almost every conversation with leading bank representatives, it became clear that many people in the United States are worrying about the future solvency of socialist countries," Polze reported. The bankers knew that the East Germans had a rising trade deficit, and "nobody knows what [we] did with the loans in the previous years."[110] Many intimated that future loans would be influenced with how transparent the socialists were about their balance of payments situation, foreign debt, and the value of their convertible currency reserves. The director of the East-West trade office in the U.S. Department of Commerce Abrahamson told the vice president of the Aussenhandelsbank

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[108] Deutsche Außenhandelsbank, "Bericht über die Dienstreise des Vizepräsidenten der Deutschen Außenhandelsbank, Genossen Dr. Polze, und des Leiters des Sektors Internationale Bankbeziehungen, Genossen Oehme, nach den USA in der Zeit vom 18.9. bis 4.10.1976," October 12, 1976, BAB, DC 20/17156.
[109] Staatsbank der DDR, "Ergebnisse der durch die DABA mit NSW-Geschäftsbanken geführten Gespräche während der LHM 1976 (Zusammenfassung)," September 9, 1976, BAB, DN 10/447.
[110] Ibid.

Werner Polze that he found it incomprehensible why the Soviet Union and the other socialist states made no information public about their balance of payments, currency reserves, and foreign debt. "As a banker," Abrahamson continued, Polze "must understand that somebody who grants credits needs the information to understand how the credits will be repaid."[111] Nevertheless, with few other opportunities, the capital flows to Eastern Europe continued. The presence of the Red Army on Eastern European soil also provided a guarantee of stability.[112]

A joke circulated in Eastern Europe about a Western banker asking a Romanian trade official whether the "country's high external indebtedness was not causing him sleepless nights. 'Not at all,' replied the Rumanian with a dash of Balkan savoir-faire. 'I sleep quite well. Why shouldn't I? After all, I'm the debtor, not the creditor.'"[113] Indeed, although socialist engagement offered the West opportunities to penetrate the Eastern bloc, it also was a risk, as the ability of the socialists to pay back the loans came increasingly into question. The terms that Western financial institutions attached the money became stricter over time; the average interest rate of medium-term loans to East Berlin increased from eight percent in 1972 to ten percent in 1975.[114]

Nobody in East Berlin had a solution to this emerging dependence on Western capital. The East Germans understood their dilemma. They needed to develop a solution that would "gradually solve the problems of the balance of payments on the main road of higher performance increase and not the reduction of economic performance through restrictive plan corrections."[115] A few officials, particularly Schürer and occasionally Mittag and Staatsbank President Margarete Wittkowski, sought to convince Honecker of the need to change direction.

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[111] Deutsche Außenhandelsbank, "Vermerk," March 18, 1976, BAB, DN 10/447.
[112] Judt, *Postwar*, 582.
[113] John Dornberg, *International Finance*, July 1976, 42.
[114] Staatliche Plankommission, "Information zu einigen Problemen der Außenhandelsbeziehungen der DDR," May 21, 1975, BAB, DE 1/58917.
[115] Willi Stoph to Erich Honecker, May 20, 1977, SAMPO, DY 30/25762.

As chairman of the State Planning Commission, Schürer was fully informed about the status of the East German economy. "The magnitude of the NSW-problem inevitably requires action," he wrote in a memorandum. If the Party did not do something to manage the deficit in the balance of payments, the East German standard of living would no longer "be affordable." East Berlin must expand its exports and limit imports, Schürer continued, "otherwise the cash problem cannot be solved." As the country sunk deeper into debt, Schürer believed that it would be even more difficult to rectify the situation. In the past, the Deutsche Außenhandelsbank received loans from Western banks to pay for imports. Now, however, much of the cash raised in the industrial democracies went to paying off previous loans and interest.[116] In December 1975, for example, Kaminsky reported that 89 percent of exports were paid for in credit, and only 11 percent were bought with cash.[117] "The fundamental issue at stake is the assurance of GDR's solvency," Schürer argued at another point. The East Germans must take "concrete steps for tangible short- and long-term increase of exports as well as for the restriction and replacement of imports from the NSW." East Berlin must find a way to make do with fewer materials from the non-socialist world and increase the performance of its manufacturing industry. Importantly, Schürer also suggested that the regime should make changes "in terms of consumption, particularly of social needs."[118]

Honecker worked hard, however, to prevent open discussion of the growing debt, avoiding difficult decisions about its relationship with the East German standard of living. Only a small cadre of policymakers understood the full economic picture. At a meeting of high-

[116] "Redekonzeption Gen. Schürer, 2.6.77," June 2, 1977, BAB, DE 1/58632.
[117] Horst Kaminsky, "Konzeption zur Finanzierung der Außenwirtschaftsaufgaben 1976 im NSW durch Beschaffung der erforderlichen Kredite," December 16, 1975, BAB, DN 10/3067.
[118] Staatliche Plankommission, "Zur weiteren Durchführung des Volkswirtschaftsplanes 1977 sowie zur Ausarbeitung des Volkswirtschaftsplanes 1978," May 12, 1977, BAB, DE 1/58633.

ranking East German officials in November 1976, Schürer, Stoph, Mittag, and many others warned about the mounting deficits and inability of East Germany to export to the West. Honecker understood the dangers and acknowledged the severity of the problem; "this is a question about the existence of the GDR….We can only achieve our objectives if we have a strong economic base." He also indicated, however, that he did not want to sacrifice domestic objectives. "We have to stick to our course," Honecker told his advisers. Production in East Germany needed to speed forward, but Honecker stressed that it must not do so "over the bones of the workers." The general secretary continued to advocate placing an emphasis on industry to earn hard currency from high-quality exports, particularly to markets in the developing world.[119] The East German tactic of simply drafting plans that called for an increase of exports to the West by as much as 33 percent in 1974 and 1974, as Ralf Ahrens has argued, "can hardly be called a strategy and reflected the absence of alternatives."[120]

The East German problem reflected a larger trend in Eastern Europe. In Bulgaria, for example, "75 percent of the national income was spent on the material and spiritual needs of the population," Todorov wrote in his memoirs. "I always thought that Bulgarian citizens had the right to want to live better. But it was as if the majority of Bulgarians did not want to understand that in order to receive more, we needed to produce more."[121] In sum, the collective debt of the Eastern Europeans quintupled from 1971 to 1976. The OECD observed in October 1978 that financing from Western banks

> enabled Eastern countries to sustain the large trade and current account deficits of the 1970s. It allowed unplanned imports, particularly of agricultural products, the

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[119] "Niederschrift über eine Beratung zum Entwurf des Fünfjahrplanes 1976-1980 unter Leitung des Generalsekretärs des ZK der SED, Genossen Erich Honecker, am 5.11.1976," November 5, 1976, BAB, DE 1/58633.
[120] Ralf Ahrens, "East German Foreign Trade in the Honecker Years," in *The East German Economy, 1945-2010: Falling Behind or Catching Up?*, ed. by Harmut Berghoff and Uta Andrea Balbier (Washington, DC: German Historical Institute; and New York: Cambridge University Press, 2013), 169.
[121] Stanko Todorov, *Do Varkhovete na Vlastta: Politicheski Memoari* (Sofia: IK Khristo Botev, 1995), 144.

> rolling over of existing debt, and the compensation of shortfalls in exports to the West resulting from both the recession in the market economy countries and the lack of competitivity [sic] of products the East seeks to export.[122]

The recession in the West may have facilitated the flow of capital to the Eastern bloc, but it also limited export opportunities in the West to earn hard currency. "Stagnation and inflation in capitalist countries created barriers to our normal commercial exchanges with them," Todorov wrote.[123]

While all states in Eastern Europe followed this trend, Poland faced the highest deficits. Warsaw's appetite for Western technology and the necessity to import Western grain after the poor Soviet harvest in 1975, the Polish debt rose quickly in the mid 1970s. Poland was the Eastern European country most integrated into the global economy. Polish First Secretary Edvard Gierek told U.S. President Gerald R. Ford, "The growth of oil prices, chemical semi-production and other raw materials, machinery and other equipment, result in quite definite difficulties faced by our economy. We can also feel the effects of increases in prices in the West which accounts for nearly half of our foreign trade."[124]

The inability of Polish manufactured goods to compete on the world market posed a significant problem. Gierek had come to power in December 1970 in the wake of a failed attempt to raise prices. Like Honecker, Gierek planned to take out loans from the West with the goal of investing in the Polish economy and improving the quality of Polish exports and increasing productivity. The U.S. embassy in Warsaw reported that in the early 1970s, "Poland encountered an international banking community which pressed money on it at extremely low rates."[125]

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[122] Trade Committee, Group on Export Credits and credit Guarantees, "Financing of East-West Trade," October 6, 1978, OECD Archive, Paris, France, TC/ECG/78.13.
[123] Todorov, *Do Varkhovete na Vlastta*, 143.
[124] "Memorandum of Conversation," July 28, 1975, NARA, RG 59, Records of Henry Kissinger, Misc. Docs, Tels, Etc., 1975 Folder 1, Box 13.
[125] U.S. embassy in Warsaw to Department of State, "Financing Eastern Europe's Trade with the West," March 13, 1976, NARA, RG 59, Electronic Telegrams, 1976.

Unfortunately, the loans did not lead to the results that Gierek sought. In the case of trade with the United States, for example, Polish officials worried that imports rose much more quickly than exports. Olszewski shared with Soviet policymakers in the Ministry of Foreign Trade that the Polish strategy had precisely the opposite of the intended effect: the Poles imported an increasing amount of manufactured goods from the United States and exporting "traditional Polish goods" such as food and artisan products. "The main task," Olszewski said, "was not the growth of trade between Poland and the United States, but changing the export structure to increase the share of machinery and equipment."[126]

As the import of Western technology and goods rose in the early 1970s, so too did consumption. Poles ate, for example, 32 percent more meat between 1970 and 1975, an appetite that was unsustainable. The problem was compounded in the mid 1970s when an agricultural shortage swept the Eastern bloc, forcing Poland to turn to the non-socialist world for imports. As noted above, the Soviet poor harvest in 1975 disrupted grain exports to Eastern Europe. In September 1975, Polish Agricultural Minister Kazimierz Barcikowski, for example, indicated to American officials that Moscow had suspended its annual 1.5 to 2 million tons of wheat shipment to Poland, and the Poles – suffering from their own agricultural problems – asked Washington for 3.9 million tons to cover their minimum requirement.[127] By the end of the 1970s, Poland would become the world's third largest wheat importer.[128]

Facing rising consumption levels at home but decreasing agricultural output, Gierek experimented with lowering the state's subsidy for food in an effort to lower domestic demand.

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[126] A. Godakov, "Memorandum o besedakh i.o. zamestitelya UTSAm tov. Mel'nikova A.V. s sotrudnikami pol'skikh vneshnetorgovykh organizatsiy," August 7, 1974, RGAE, f. 413, op. 31, d. 6660.
[127] Robert Hormats to Brent Scowcroft, "Your Meeting with the President," September 30, 1975, GFPL, National Security Adviser Files, NSC Europe, Canada, and Ocean Affairs Staff Files, 1974-1977, Poland, 1975 (2) WH, Box 16.
[128] James, *International Monetary Cooperation Since Bretton Woods*, 564.

This was a sudden and centralized decision; the Sejm, the Polish legislature, did not know about the price hikes until just hours before it was due to pass them.[129] In June 1976, the government increased the price of meat and fish by an average of 60 percent (including meat by 69 percent). The action precipitated strikes at 130 factories around the country, confirming the fears of Eastern European leaders that shifting the burden of rectifying the balance of payments deficits onto the people would jeopardize the stability of the socialist regimes. The very next day, Prime Minister Piotr Jaroszewicz went on television and called off the price adjustment.[130] The CIA reported that tensions remained high after the episode, and populace began hoarding consumer items in anticipation of future price hikes, making shortages worse. The situation deteriorated to the point that the regime had to introduce sugar rationing.[131] While the average real rate of consumption was nine percent for the first half of the 1970s, it fell to four percent for the rest of the decade.[132]

The protest had a profound impact on the opposition in communist Poland. In December 1975, a group of intellectuals had protested about the state's decision to make the leading role of the communist party a feature of the Polish constitution. After the popular uprising among workers against the price hikes the following summer, the workers found willing allies in the intellectuals. In September 1976, an alliance of intellectuals and workers founded the Workers' Defence Committee (*Komitet Obrony Robotników*, or KOR), an organization that developed into a serious opposition movement against the communist regime. Leaders of the KOR such as Adam Michnik encouraged more dialogue between the Polish left and the Catholic Church,

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[129] Ouimet, *The Rise and Fall of the Brezhnev Doctrin*e, 106.
[130] Kotkin, "The Kiss of Debt," 85.
[131] CIA Intelligence Memorandum CI 76-10173, November 10, 1976, FRUS 1969-1976, Vol. E-15, Part 1: Documents on Eastern Europe, 1973-1976, doc. 57.
[132] James, *International Monetary Cooperation Since Bretton Woods*, 564.

seeking to tap into the strong support of the Church among the masses. The election of Archbishop of Kraków Karol Józef Wojtyła as pope in October 1978 gave the opposition confidence that God was on their side.[133]

The imprisonment of famous members of KOR had a deleterious effect on Poland's reputation in the West at a time when Warsaw needed to attract capital from Western financial institutions. Like East Germany, Poland also experienced a decreased interest among Western bankers to extend loans in the mid 1970s. After the collapse of the Franklin and Herstatt bank failures, financial institutions tightened their lending practices. In addition, bankers worried about Poland's growing indebtedness. The American embassy in Warsaw noted that Poland's financial woes provided more opportunities for the West to penetrate the country. The U.S. group of Poray, Turner Construction, and Hilton Hotels, for example, received government approval to construct a joint-operation with the Polish government. Warsaw wanted to attract more Western tourists to Poland as a source of hard currency. The Poles understood that they could not undertake any major economic initiatives "without being concerned about how it will be interpreted in the financial circles of New York, London, and Frankfurt." Bankers still considered Poland a "very good long-term credit risk" and were willing to extend loans to the country, but they worried about the short-term financial crunch.[134] The events of June 1976 only served to "strengthen their already great reluctance to provide financial credits to Poland."[135] Western European diplomats and bankers privately approached the U.S. government, lobbying unsuccessfully for Washington to bail out Poland.[136]

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[133] Brown, *The Rise and Fall of Communism*, 423-26

[134] U.S. embassy in Warsaw to Department of State, "Financing Eastern Europe's Trade with the West," March 13, 1976, NARA, RG 59, Electronic Telegrams, 1976.

[135] U.S. embassy in Warsaw to Department of State, "Polish Debt," September 3, 1976, NARA, RG 59, Electronic Telegrams, 1976.

[136] U.S. embassy in Warsaw to Department of State, "Some Western Creditors Hope the U.S. Will Bail Poland Out," November 13, 1976, NARA, RG 59, Electronic Telegrams, 1976.

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"In short," foreign correspondent John Dornberg observed in 1976, "what Marxist theorists had refused to believe possible, is now a fact: The planned socialist economies are as susceptible to the vicissitudes of the cycle as the 'crumbling' bastions of capitalism."[137] The socialists' decision to reengage the global capitalist economy in the late 1960s and early 1970s made them susceptible to economic disruption, and the global oil crisis of 1973 reverberated across CMEA. It occurred at a particular moment of vulnerability, when the Soviet energy industry began to hit a plateau and the Eastern Europeans increasingly depended on energy imports to power export industries.

As the position of the Eastern European economies deteriorated, the importance of Western financial institutions played an increasing role in ensuring that the socialists remained solvent. The socialists' "big bet" on high technology to repay loans was failing: the West showed little interest in purchasing inferior quality goods from Eastern Europe, particularly as capitalist struggled with a recession. In order to insulate their populations from bearing the brunt of socialism's failings, regimes turned to the West to protect their standard of living. In East Germany, for example, policymakers recognized their growing dependence on the industrial democracies. Mittag later admitted that without the availability of loans from Western banks, at the time flush with petrodollars, he doubted that East Germany would have survived the decade. Had the East Germans not received credits, it would have "been a funeral for the GDR in the 1970s."[138] While these loans delayed East Germany's ultimate economic reckoning, they undermined the country's sovereignty and placed it on the road toward becoming dependent on Western bankers.

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[137] John Dornberg, *International Finance*, July 1976, 42.
[138] Mittag, *Um jeden Preis*, 61-63.

Chapter 6

"The Will to Do It is Not Yet Strong Enough": Jimmy Carter, Helmut Schmidt, and the Travails of the Dollar

As the neoliberal turn began to gain steam in the mid 1970s, the 1976 presidential election brought a Keynesian to the White House for the final time during the Cold War. Carter believed that inflation was an evil that needed to be defeated, but he also believed in the Democratic Party's long-standing commitment to full employment. Across the Atlantic, in contrast, West German Chancellor Helmut Schmidt believed in following a disciplined monetary policy, aimed at avoiding the kind of inflation that had existed in the early 1920s. He worried that U.S. deficits, principally driven by large oil imports, would have effects on Western Europe. U.S. spending was unsustainable. The British had agreed to enact disciplinary measures in the fall of 1976 as a condition for receiving a loan from the International Monetary Fund. Now it was the United States' turn to go to the doctor to take its medicine, placing the interests of the foreign holders of the dollar ahead of American consumers.

This chapter makes two arguments. First, the dollar's weakness played a central role in the creation of the European Monetary System. The Western Europeans, led by West German Chancellor Helmut Schmidt, responded to what they saw as economic mismanagement in the United States and sought to shield themselves from the deleterious effects across the Atlantic. The birth of the EMS signaled that the Western Europe had developed into a robust bloc capable of organizing itself without consultation with Washington. As Emmanuel Mourlon-Druol notes, the United States played an active role in promoting Western European integration during the early Cold War. Now, however, Washington was simply told what had happened.[1] After three years of a non-system, the European Community decided to embark on its own path in international monetary policy, effectively closing the door to any kind of reconciliation in the Atlantic Community for a new system that would replace Bretton Woods.

Second, this chapter identifies November 1978 as the point at which Washington finally accept limits to its autonomy in international monetary affairs. In the heyday of Pax Americana, the privileged position of the United States allowed it to export debt with impunity and resist calls from abroad to manage spending. Even in the 1970s, the Richard Nixon and Gerald Ford refused to place the burden of adjustment on American consumers, choosing instead to pursue solutions to U.S. economic problems in the international sphere. Nixon decided in August 1971 to decouple the dollar from gold, for example, and demanded that the rest of the world figure out how to solve the U.S. deficits. The abandonment of Bretton Woods by 1973 established a *de facto* dollar standard that allowed the United States to access to the world's resources through its currency. By 1978, with some $500 billion in dollar-denominated assets in the hands of foreigners, however, the United States no longer had the freedom to enact an expansionary economic policy without fear that investors would dump their dollars.

The dollar crisis of fall 1978 and Carter's subsequent decision to intervene to support the dollar in November 1978 marked the first point that an American president sacrificed an expansionary domestic agenda to reassure foreigner holders of dollars. The contrast between August 1971 and November 1978 could not be starker; while Nixon insisted that the burden of adjustment should fall on the rest of the world, Carter accepted the need to make changes at

[1] Emmanuel Mourlon-Druol, *A Europe Made of Money: The Emergence of the European Monetary System* (Ithaca, NY: Cornell University Press, 2012), 210.

home to satisfy foreigners. This action paved the way for the so-called “Volcker shock” in 1979, a harsh series of monetary measures designed to decrease the money supply and raise interest rates. Although it came at a tremendous social cost for American workers and inflicted a high political cost for Carter, the Volcker shock indicated to the world that Washington was serious about fighting inflation. The benefits would not be clear until after Carter left office, but the discipline that he and Volcker imposed marked an important step toward the resurgence of capitalism in the early 1980s.

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Compared with the heads of state of the other major industrial democracies, new U.S. President Jimmy Carter was poorly equipped to deal with economic crises. Carter’s peers - Helmut Schmidt in West Germany, James Callaghan in Britain, Valéry Giscard d’Estaing in France, and Takeo Fukuda in Japan–had served as economics or finance ministers before taking the highest office in their countries and had spent most of the decade fighting inflation, chaos in the international monetary system, and energy shortages. Carter, in contrast, had held positions in Georgia state politics after a brief career as a peanut farmer. A graduate of the U.S. Naval Academy with a degree in engineering, Carter had a keen mind for technical detail and earned widespread praise for his work ethic, but he lacked the educational and practical training in international economics that his peers in Western Europe and Japan possessed. Before his first G7 summit in London in May 1977, Carter wrote in his diary that he was “at somewhat of a disadvantage in discussing the finance matters.”[2] Carter admitted to his interlocutors at the first session of the summit that he “came to the meeting not as an economist but as a student.”[3]

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[2] Diary entry for May 6, 1977, in Carter, *White House Diary*, 46-47.
[3] “Note of the First Session of the Downing Street Summit Conference at 10 Downing Street on Saturday 7 May 1977 at 1020,” UKNA, FCO 82/764.

Despite his inexperience in matters of international affairs, Carter and his advisers articulated an ambitious program for U.S. foreign policy.[4] Carter sought to rise above the balance-of-power politics that he accused his predecessors of pursuing, choosing instead to promote human rights and strengthen relationships between the three centers of democratic and economic power–North America, Japan, and Western Europe–as his guiding principles.[5] It was necessary to "initiate a new phase in U.S. foreign policy," his advisers argued, "going beyond the Atlanticist/East-West Cold War framework of the years 1945-1976."[6] In particular, the administration wanted to use the G7 as a forum for the promotion of cooperation among the three regions; the summits would give "substance to [the] trilateral focus."[7] The president and many of his closest advisers, notably National Security Adviser Zbigniew Brzezinski, adhered to the principles of the Trilateral Commission, an organization that advocated close cooperation among the major industrial regions to solve common economic and social issues. Because of their wealth, North America, Japan, and Western Europe "have a special burden of responsibility to the rest of mankind" to serve as the engines for the rest of the global economy.[8]

Carter's platform stimulated a debate about the proper role for the United States in international affairs, attempting to infuse U.S. foreign policy with morality in the aftermath of the travails of the Vietnam War and the Watergate scandal that had left the country searching for direction.[9] The Nixon and Ford administrations had reacted to the implications of economic

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[4] Zbigniew Brzezinski to Jimmy Carter, "Four-Year Foreign Policy Objectives," April 1977, Jimmy Carter Presidential Library (JCPL), Atlanta, GA, Brzezinski Collection, Four-Year Goals [4/77], Box 23.
[5] Brzezinski, *Power and Principle*, p. 48.
[6] Zbigniew Brzezinski, Richard Gardner, and Henry Owen to Jimmy Carter, "Foreign Policy Priorities for the First Six Months," November 3, 1976, Sterling Memorial Library Manuscripts & Archives, Yale University, New Haven, CT, Cyrus R. and Grace Sloane Vance Papers, Sterling Library, Vance Papers, MS 1664, Series II, Box 9, Folder 19.
[7] "An Early Economic Summit?," undated, Sterling Library, Vance Papers, MS 1664,, Series II, Box 8, Folder 4.
[8] Zbigniew Brzezinski, Richard Gardner, and Henry Owen to Jimmy Carter, "Foreign Policy Priorities for the First Six Months," November 3, 1976, Sterling Library, Vance Papers, MS 1664, Series II, Box 9, Folder 19.
[9] Smith, *Morality, Reason, and Power*, 3.

globalization and recalibrated their foreign policies to comport with accelerating interdependence, and Carter sought to make it explicitly a central component of his foreign policy platform upon assuming office. Although Carter's emphasis on human rights broke from his predecessors, his desire to engage "world order politics" did not mark a radical break from the Nixon and Ford administrations, as other scholars have suggested. It rather represented the public culmination of a shift in U.S. foreign policy that was already well underway since the early 1970s.[10]

The declining dollar in 1977 gave the Carter administration its first major opportunity to place the trilateral foreign policy into action. The weakness of the dollar stemmed from several factors. First, the United States ran current account and trade deficits brought about primarily by oil imports. In 1977, the United States consumed 18 million barrels of oil per day–a figure that represented a third of total world oil consumption.[11] Before the 1973 oil shock, the United States spent $9 billion on oil imports; by 1977, that number ballooned to $48 billion.[12] The deficits contributed to a second factor: widespread concern about the future of the American economy, particularly with regard to the administration's ability and willingness to tackle inflation and limit its oil imports.[13] Finally, the globalization of finance in the 1960s and 1970s created highly mobile transnational capital that could move quickly from one currency into another. Fearful of

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[10] Carter's initial emphasis on world order politics pitted Brzezinski against Secretary of State Cyrus R. Vance, who advocated a more traditional foreign policy that centered on the Soviet Union. In his memoirs, Vance writes that "our main problem as the administration came to power was to contain Soviet expansion while reinvigorating the long-term American effort to moderate U.S.-Soviet tensions." Cyrus R. Vance, *Hard Choices: Critical Years in America's Foreign Policy* (New York: Simon & Schuster, 1983), 45. For a recent interpretation that views Carter's initial agenda as a break from the past, see Zanchetta, *The Transformation of American International Power in the 1970s*, 189-203.

[11] Daniel J. Sargent, *A Superpower Transformed: The Remaking of American Foreign Relations* (New York: Oxford University Press, 2015), 243.

[12] UKTSD paper, "The Outlook for the Dollar," August 31, 1978, UKNA, T 382/93.

[13] For a recent analysis of the politics of Carter's energy program, see Meg Jacobs, *Panic at the Pump: The Energy Crisis and the Transformation of American Politics in the 1970s* (New York: Hill & Wang, 2016), 161-95.

the future trajectory of the dollar, international speculators and OPEC began to move their money out of the United States and into safer destinations such as the yen, Swiss franc, and D-mark. The decline of the dollar made it more difficult for Saudi Arabia to resist OPEC demands to raise the price of oil–denominated in dollars–because the members of OPEC sought to recoup losses in the dollar by raising oil prices.[14] From September 1977 to October 1978, the dollar fell by 40 percent against the yen, 35 percent against the Swiss franc, 13 percent against the D-mark.[15]

Foreign critics demanded that the Carter administration protect the value of the dollar. Suggestions included U.S. intervention in the market to support the currency and the implementation of domestic measures to reduce the trade deficit. Carter agreed that the administration needed to reduce the country's energy bill, and he introduced his energy plan in April 1977, claiming that combatting the energy crisis was the "moral equivalent of war." This proposed legislation included extended natural gas price controls to the intrastate market, a tax on crude oil to raise domestic oil prices to global levels, a tax on automobiles, efficiency standards for industry, and the extension of tax credits to consumers that switched to renewable energies. Carter's program failed, however, to garner support from Congress and the American public, which both did not want to limit consumption and did not think that they needed to do so.[16]

With respect to the dollar, the administration opted to allow the market to work. Treasury in particular argued that the U.S. economic situation reflected the normal swings of the market.

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[14] Anthony M. Solomon, "Memorandum for the President: International Financial Issues On Your Trip," December 27, 1977, NARA, RG 56, Records of Assistant Secretary for International Affairs C. Fred Bergsten, 1977-1979, Briefing Papers (BP), Box 1.
[15] Robert Solomon, *The International Monetary System 1945-1981* (New York: Harper & Row, 1982), 344.
[16] Jacobs, *Panic at the Pump*, 173-74.

While foreigners complained about the decline of the dollar, Under Secretary of the Treasury Anthony M. Solomon downplayed its significance, pointing out in the summer of 1977 that the movements in the exchange rates were not unprecedented; since early 1973, the dollar had gone through periods of relative stability and erraticism. In fact, the dollar had remained stable for the previous two years and its decline had been against the currencies of the surplus countries (West Germany, Japan, and Switzerland).[17] American policy since the turn to floating exchange rates had "been to rely on the markets to determine the exchange rate and to limit intervention to that needed to counter disorderly market conditions." The trade and current account deficits as well as a lack of international confidence drove the dollar downward, but Solomon stressed that the Carter administration should continue to trust the market. "We do not need to change our intervention policy….We have advocated flexibility in exchange rates to bring about adjustment–and we should not be surprised when rates move," Solomon concluded.[18] Furthermore, American export competitiveness remained strong, and income from foreign investment ($12 billion) partially counterbalanced the high oil import bill.[19] "Our basic objective with respect to the dollar and our balance of payments," Blumenthal and Schultze wrote Carter in early 1978, "is to maintain a position which enables us to pursue our domestic economic objectives both in the short run and in the longer term within a healthy world economy." With an eye on preserving Carter's domestic agenda, they concluded that the small depreciation of the

[17] W. Michael Blumenthal, "Memorandum for the Vice President: The Trade Balance and U.S. Monetary Policy (Draft)," July 29, 1977, NARA, RG 56, Records of Assistant Secretary for International Affairs C. Fred Bergsten, 1977-1979, IM-6 Balance of Payments 1977, Box 1.
[18] Anthony M. Solomon to W. Michael Blumenthal, "Exchange Rates and U.S. Exchange Market Policy," July 26, 1977, NARA, RG 56, Chronological Files of Thomas Leddy, Deputy Director of the Office of International Monetary Affairs, 1970-1979, TL Chron July-August 1977, Box 6.
[19] W. Michael Blumenthal, "Memorandum for the President: The U.S. Trade Balance," undated (likely late summer 1977), NARA, RG 56, Chronological Files of Thomas Leddy, Deputy Director of the Office of International Monetary Affairs, 1970-1979, TL Chron July-August 1977, Box 6.

dollar compared to most OECD countries (i.e., countries other than West Germany, Japan, and Switzerland) did not require a new strategy.[20]

Because the U.S. economy expanded at a greater rate than most of the other industrial democracies, the Carter administration sought to remedy the country's problems through diplomacy in the international sphere. Carter sought to enlist the support of West Germany and Japan to stimulate their economies, a coordinated program that he expected would reduce the surpluses in those countries. The Carter administration believed that increased demand in West Germany and Japan would lift the global economy out of recession and increase the demand for U.S. goods. The solution to changes in the exchange rate between the dollar and the D-mark "could only be found on the German side," the Americans told a group of West German representatives.[21] This so-called "locomotive strategy" had the advantage of placing responsibility for rectifying the U.S. deficit on Bonn and Tokyo, allowing Carter to maintain an expansionist policy at home.[22] The locomotive strategy represented a reformulation of classic Keynesian strategies, applied in an international context. Some in the administration recognized that domestic measures might be necessary in the future, but, as Chairman of the Federal Reserve Board Arthur Burns said in January 1978, "the will to do it is not yet strong enough."[23]

Carter has come under fire from contemporaries and historians for not taking steps domestically to stabilize the dollar in 1977, but he was right to point the finger at Bonn and

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[20] W. Michael Blumenthal and Charles L. Schultze, "Memorandum for the President: Contingency Planning with Respect to the Dollar," January 19, 1978, NARA, RG 56, Leddy Chron, TL Chron TL Chron Jan-Feb 1978, Box 6.
[21] West German embassy in Washington to AA, "Informationsreise der Bundestagsabgeordneten Dr. Müller-Hermann und Dr. Sprung nach Washington vom 28. bis 30 März 1978," April 7, 1978, PA-AA, B 52 (ZA), Bd. 124321.
[22] The locomotive strategy emerged from the public recommendation of 16 economists from Europe, Japan, and North America who had met at the Brookings Institution in early November 1976, and a similar idea was published in the OECD *Economic Outlook* in December 1976. Solomon, *The International Monetary System 1945-1981*, 310.
[23] "Some Parting Thoughts: Address by Arthur F. Burns, Chairman, Board of Governors of the Federal Reserve System at the National Press Club, Washington, D.C.," January 30, 1978, JCPL, CEA, Charles L. Schultze's Subject Files, Burns, Arthur [1], Box 8.

Tokyo as contributors to the problem.[24] Collective management of the international economy meant that countries needed to ensure that they did not run chronic deficits, but it also meant that countries should not have persistent surpluses. Some of the burden of adjustment, Carter believed, needed to be carried by West Germany and Japan. The British and French joined the Americans in criticizing West Germany's "slack performance" in stimulating its economy to reduce its surplus, and put "heavy pressure on the Japanese to deal with their current account surplus."[25] Despite reluctant promises by Schmidt and Fukuda, both countries failed to expand their economies. At the London Summit of May 1977, for example, Carter, Schmidt, and Fukuda agreed to informal growth targets, but the compromise fell apart by the fall as it became clear that West German and Japanese growth lagged behind the targets while U.S. growth kept pace with the target.[26] Because Japan had become a new economic superpower, Washington wanted "to prod the Japanese to assume the international role their economic weight both entitles and obligates them to adopt."[27] These responsibilities included ensuring that the Japanese reached their stated growth target, move to make their current account into deficit, make long term moves to increase imports of manufactured goods. Instead, Japan's current surplus reached more than $10 billion by the end of 1977.[28]

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[24] Switzerland ran a large surplus as well, but its importance to the global economy paled in comparison to the other two.
[25] Anthony M. Solomon, "For the White House Report: Report on Paris Meeting," December 8, 1977, NARA, RG 56, Chronological Files of Thomas Leddy, Deputy Director of the Office of International Monetary Affairs, 1970-1979, TL Chron Nov.-Dec. 1977, Box 6.
[26] Sargent, *A Superpower Transformed*, 242.
[27] C. Fred Bergsten to W. Michael Blumenthal, "Japanese Sub-Cabinet Meeting," August 31, 1977, NARA, RG 56, Bergsten, Meetings (MTG'S), Box 1.
[28] W. Michael Blumenthal, "U.S. Policy Toward Japan," November 8, 1977, NARA, RG 56, Records of Assistant Secretary for International Affairs C. Fred Bergsten, 1977-1979, IM-6 Balance of Payments 1977, Box 1.

West German Chancellor Helmut Schmidt fumed at the American unwillingness to take responsibility for limiting oil consumption and enact painful but necessary measures to reduce its energy bill. Schmidt had served as both minister of economics and finance under Willy Brandt, and had risen to become the most experienced head of state in dealing with economic issues. Schmidt had allied with the United States during the crises of the mid 1970s, joining President Gerald Ford to counter the New International Economic Order, French plans for a return to Bretton Woods, and the imposition of discipline on British socialism. Schmidt balanced West German Atlanticist and Europeanist objectives, but relations with the United States took center stage as global problems beckoned and European integration stalled. When Ford lost the presidential election to Carter, however, Schmidt lost a friend and a U.S. president whom he trusted. Carter's lack of depth in international economic affairs aggravated him, and he saw Carter's inexperience and support for Keynesian deficit spending as a dangerous combination. Schmidt believed, "Keynes' demand management no longer produced growth: it could push up wages and prices but not create growth."[29]

Schmidt's exasperation with Carter defined a cold relationship between the two men that played out both behind closed doors and in the media. Schmidt especially chastised Carter for the latter's dogmatic promotion of human rights, which the chancellor believed foolish because it antagonized the Eastern bloc and made it more difficult to establish inter-German ties across the Iron Curtain. The chancellor believed that Carter's idealistic rhetoric only served to inhibit real progress with the Soviet Union, which protested that Carter interfered in Soviet internal affairs.[30] The tension increased when Schmidt bristled at the Carter administration's public opposition to

[29] "Note for the Record: Prime Minister's Meeting with Chancellor Schmidt at Chequers on Sunday 23 April 1978 at 1945," UKNA, PREM 16/1655.
[30] Schmidt titled a chapter in his memoirs: "Jimmy Carter: Idealistic and Fickle." See Helmut Schmidt, *Men and Powers: A Political Retrospective*, trans. by Ruth Hein (New York: Random House, 1989).

the West German sale of nuclear technology to Brazil (which violated Bonn's obligations under the Non-Proliferation Treaty of 1968), eliciting strong West German protests against what it saw as American unilateralism. When Carter complained to Brzezinski in April 1977 that Schmidt had "been quite obnoxious to me," the national security adviser responded, "you have been quite obnoxious to him."[31] The discord in the Washington-Bonn axis during the Carter administration would cast a shadow on Atlantic unity, marking the nadir of U.S.-West German relations in the postwar era.

Given the size of the U.S. economy, troubles across the Atlantic could spread to West Germany, but Schmidt believed that the responsibility for handling U.S. problems rested in Washington. Above all, the West German government blamed the seemingly insatiable appetite for imported oil in the United States. The "growing U.S. dependence on imported oil will worsen the U.S. balance of payments deficits and weaken the position of the dollar internationally."[32] The chancellor told British Prime Minister James Callaghan in March 1978 that "it was up to the U.S. to promote growth." Schmidt accepted that he may eventually be forced to "take some measures" at home in West Germany but suggested that "he might even resign rather than do so."[33] Above all, the chancellor feared that stimulating the West German economy would increase inflation. At the same time, Schmidt worried that what he saw as careless U.S. policy and the weakness of the dollar would also lead to upward pressure on prices in West Germany as speculators dumped dollars for D-marks. The responsibility to correct U.S. weaknesses should fall to Washington, Schmidt believed, not Bonn. The Japanese agreed, and Tokyo instructed

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[31] Brzezinski, *Power and Principle*, 292.
[32] BMWi III D 2, "Staatsbesuch Präsident Carters in der Bundesrepublik Deutschland vom 13.-15.Juli 1978," June 26, 1978, PA-AA, B 52 (ZA), Bd. 124321.
[33] "Note for the Record: Prime Minister's Meeting with Chancellor Schmidt at the Bundeskanzlei, Bonn, on Sunday, 12 March 1978," UKNA PREM 16/1656.

every Japanese official who had contact with an American counterpart to demand that the United States do something to promote currency stability.[34]

Exasperation with Carter's economic policies was not confined to the Federal Republic. Others in Western Europe shared Schmidt's concerns. Many viewed the slide of the dollar with an exasperated sense of *déjà vu*. During the late 1960s and early 1970s, the U.S. balance of payments deficits and the weakness of the dollar led speculators to flee to stronger currencies such as the West German D-mark and the Dutch guilder. This destabilized the Western European economies and placed inflationary pressure on prices. To Western European officials, the weakness of the dollar and apparent policy of benign neglect toward the U.S. deficit recreated in 1977 and 1978 the constellation of forces that had caused the collapse of Bretton Woods. The European Council expressed concern about the level of U.S. oil imports, a burden on the U.S. balance of payments that "led to a breach of trust in the exchange rate of the dollar."[35]

As a means of sheltering themselves from the collapse of the dollar, the Western Europeans committed at the Bremen Summit of July 1978 to establishing a European Monetary System (EMS). Building on a speech by European Commission President Roy Jenkins in Florence in October 1977, the EMS reignited progress toward European integration that had stalled in the mid 1970s. From the perspective of transatlantic relations, the logic of the project was that "the burden of pursuing a policy of holding the EMS down against the dollar would be shared among different countries."[36] Schmidt was the project's primary advocate and had introduced it at the European Council in April 1978, and the proposal was generally met with

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[34] C. Fred Bergsten to W. Michael Blumenthal, "EPG Meeting on Japan," April 3, 1978, NARA, RG 56, Records of Assistant Secretary for International Affairs C. Fred Bergsten, 1977-1979, BP-4 Briefing Memos, Box 2.
[35] "Informatieve nota inzake huidige monetaire ontwikkelingen in de EEG t.b.v. de Europese Raad d.d. 7 en 8 april 1978 te Kopenhagen," Nationaal Archief (NNA), The Hague, Netherlands, 2.06.107, 2928.
[36] A.C.S. Allan, "Lead in the Balloon," July 27, 1978, UKNA, T 385/256.

approval.[37] The Dutch Ministry of Finance, for example, concluded that "in light of the current unstable situation in the monetary system, the Netherlands is strongly in favor of agreements to promote greater mutual price stability in Europe."[38] Members generally agreed about the necessity to "turn away from the dollar and from U.S. financial policy."[39] In a region with a high volume of internal trade, the stabilization of monetary relations would minimize currency fluctuations and provide a greater measure of certainty to Western European markets.

While the Western Europeans agreed about the desirability of protecting themselves from the weakness of the dollar, there existed tremendous discord about the structure of a new regional monetary system. In particular, widespread concern about West Germany's disproportionate economic strength came to the surface. The debate centered on whether the EMS should take the form of the "Snake" (that had existed since early 1972) in which all currencies were tied to each other and floated as a unit against other currencies, or a "basket" system in which each currency could fluctuate within an agreed band of its rate against the average of all members of the system. The battle line was drawn in the same place that it had been during the debates about integration in the early 1970s: between the economists and monetarists, between members of the Snake and non-members, and between strong- and weak-currency countries.[40] The West Germans promoted the expansion of the Snake, a structure that meant countries with weak currencies would bear the burden of adjustment to keep pace with the strength of the D-mark.[41] Bonn saw exchange rate stability as a precondition for a lower

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[37] On Schmidt's role, see Kristina Spohr, *The Global Chancellor: Helmut Schmidt and the Reshaping of the International Order* (New York: Oxford University Press, 2016), 27-32.
[38] "Notitie inzake het Europese Monetaire Stelsel," November 2, 1978, NNA, 2.06.107, 2929.
[39] "Prime Minister's Discussion on 8 April with Chancellor Schmidt and President Giscard," 11 April 1978, UKNA, PREM 16/1615.
[40] See chapter one.
[41] Referat VIIA4, "Leitlinien zur Ausarbeitung des Europäischen Währungssystems," July 21, 1978, Bundesarchiv (BAK), Koblenz, Germany, B 126/70439.

exchange rate for the D-mark; holding down the currency would allow West Germany to maintain its export-led growth. West Germany was supported by the other members of the Snake, including Belgium, Luxembourg, the Netherlands, and Denmark.[42] These countries all had a high volume of trade with West Germany and believed that the Snake had "proven itself to work well in practice." The countries that still participated in the Snake benefited from the certainty that exchange rates among them would stay constant, allowing them to have close business relationships. The Dutch Ministry of Finance wrote that even if the Community chose another format for the EMS, the Snake should stay in force.[43]

Britain and Italy–states with weaker currencies–feared that joining the Snake would mean that they would have to deflate their economies to keep pace with West Germany. Under the terms of the Snake, when one currency reached its intervention margin, there would always be another currency at its intervention margin at the opposite end. The responsibility to implement restrictive policies would fall on the country with the weaker currency because it would lose reserves as pressure would build on its exchange rate.[44] Britain in particular worried that sterling's weak position would make it a target for speculation if it had to keep pace with the much stronger D-mark. Sterling was "likely to be the first to attract speculative attention if it were in the scheme." The Treasury feared that sterling would be the "lead in the balloon," holding the D-mark and other strong Western European currencies from floating too high.[45] The British were skeptical about a system that placed "pressures on all participating countries to appreciate at the speed of the D-mark against non-participants, especially the dollar, and does not

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[42] EEC Finance Council: Meeting in Brussels, on 24 July 1978," UKNA, T 385/256.
[43] Directie Buitenlandse Financiële Betrekkingen, "Nota inzake het Europees Monetair Stelsel," October 5, 1978, NNA, 2.06.107, 2928. The West Germans shared this objective.
[44] M.J. Mitchell, "The Proposals for a European Monetary System, November 13, 1978, UKNA, T 382/71.
[45] A.C.S. Allan, "Lead in the Balloon," July 27, 1978, UKNA, T 385/256.

therefore contain a deflationary bias."[46] The French franc and Italian lira also might be exposed to speculative assault at the bottom of the Snake. They had all withdrawn from the Snake in the past and had no reason to believe that an EMS conceived around the Snake would be any different.

In order to fight against West German domination of the system, these countries supported a basket system. Each currency would fluctuate within an agreed band of its exchange rate against the average of all the members of the system. This meant that if the D-mark rose too quickly, the burden to adjust would fall on Bonn alone, and the other members of the EMS would not need to keep pace with West German strength.[47]

A third option emerged that sought to bridge the gap between the two: the so-called Belgian compromise.[48] This third way blended the Snake with an "indicator of divergence"–a mechanism to determine a deviant currency. When a currency exceeded its divergence threshold, the central bank would be obligated to intervene in the exchange markets to correct the change in parity.[49] The Snake would endure, but it would also contain an indicator would track the movement of all currencies so as to identify the deviant currency. This compromise allowed the West Germans and French reconcile their positions, as well as encouraging the Italians and Irish to join.[50] The outcome closely resembled the Snake with the addition of a divergence indicator, leading one historian to label the EMS as the "rattlesnake."[51] The British joined the system but

[46] Ibid.
[47] Finance Council, "EMS-Monetary Aspects," November 20, 1978, UKNA, T 382/71.
[48] Mourlon-Druol contends that the Belgian compromise was probably British or Dutch in origin. See Mourlon-Druol, *A Europe Made of Money*, 210.
[49] National Bank of Belgium, "Combination of the Parity Grid and the Indicator of Divergence: Implications of the 'Belgian Compromise,'" October 23, 1978, BAK, B 126/70441.
[50] British reluctance made Irish entry more difficult. Half of Irish exports went to Britain. Because the Irish depended on close relations with the British economy, Dublin linked the punt to the pound. Ireland looked to Britain to secure short-term and long-term capital, and the fixed relationship between the currencies limited any exchange rate risk. Denis Healey, "EMS: The Pound Sterling and the Irish Pound," undated, UKNA, T 382/71.
[51] Mourlon-Druol, *A Europe Made of Money*, p. 258.

refused to participate in the exchange-rate intervention obligation, which some charged "as analogous to trying to play Hamlet without the Prince."[52]

The weakness of the dollar alone did not lead to the EMS; Western European integration has a much more complicated history with a series of successes and setbacks.[53] The dollar crisis, however, had much to do with the *timing* of this urgent push in 1978. The historian Emmanuel Mourlon-Druol argues that "the EMS was more the outcome of what was 'in the air' already, rather than a sudden qualitative leap forward," but it is hard to imagine that the EMS would gain widespread support among Western Europeans without the specter of the weak U.S. dollar, a development unique to the context of 1978. Mourlon-Druol further contends that the EMS initiative had a "fundamental political nature."[54] It is clear that the integration project had political roots, but the EMS emerged when it did because of instability in the global economy amid uncertainty about the dollar.

The Carter administration publicly supported the EMS, but many American officials privately expressed concern–a fact not lost on the Europeans.[55] The EMS proposal presented Washington "with an immediate problem," Solomon wrote in the summer of 1978. The U.S. broadly supported the goal of European integration in the name "a stronger European defense" against communism, but Anthony Solomon feared that the EMS would "overturn the fundamental premise" of the revised Articles of Agreement of the IMF. The EMS would "revert

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[52] Michael Emerson, "The United Kingdom and the European Monetary System," June 1979, BAK, B 126/88637.
[53] For an excellent monograph that traces the evolution of the idea and politics of the EMS during the course of the 1970s, see Mourlon-Druol, *A Europe Made of Money*.
[54] Mourlon-Druol, *A Europe Made of Money*, pp. 9, 225-26. A similar argument is made by Matthias Schulz, who sees the EMS as a reaction to the discrepancy between European economic and political weight in international affairs. See Schulz, "The Reluctant European: Helmut Schmidt, the European Community, and Transatlantic Relations," in *The Strained Alliance: U.S.-European Relations From Nixon to Carter* (Washington, D.C.: German Historical Institute; and New York: Cambridge University Press, 2010), 306.
[55] See, for example, Tammenoms Bakker aan MBZ, "U.S. Reaktie op Europees Monetair Stelsel," 23 oktober 1978, NNA, 2.06.107, 2035; and Nicholas Henderson, "European Monetary System," August 7, 1978, UKNA, T 385/141.

to the approach of the Bretton Woods system," and Solomon stressed that "we must not allow ourselves to be put back in the strait jacket of the Bretton Woods system where other countries controlled the competitive position of American producers, and thus American jobs."[56] More broadly, the EMS provided a monetary challenge to Washington, further cementing the European Community as an economic juggernaut capable of competing with the United States.

The EMS represented the growing economic power of Western Europe in international economic affairs, and the ability of West Germany in particular to effect change without American consent. Indeed, Bonn recognized the political implications of the birth of the EMS; the West German Finance Ministry noted in November 1978 that the EMS signaled the "growing power of Europe" on the world stage.[57] The EMS was conceived in opposition to the United States, solidifying Western Europe as a third, more independent force in international economic affairs. In October 1980, the West German Minister of Finance Hans Matthöfer wrote that the EMS had "in its 1.5 years of existence strengthened monetary and political stability in Europe and facilitated cooperation of governments and central banks in these areas."[58] The new system created the European Currency Unit (ECU) as a unit of account for payments within the Community, a development that made it possible to decrease European reliance on the dollar. The EMS "changed[d] the nature of the world monetary system quite profoundly," the British Treasury concluded in August 1978. This represented a missed opportunity to reconstruct an international monetary system. Viable options did exist, including a compromise that decentered the dollar and increased the role of SDRs as reserve currencies. The instability of the dollar and

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[56] Anthony M. Solomon to Henry Owen, "European Monetary Arrangements," no date (included in folder containing material from July and August 1978), Chronological Files of Thomas Leddy, Deputy Director of the Office of International Monetary Affairs, 1970-1979, TL Chron July-August 1978, Box 6. The text was underlined in the original document.
[57] BM der Finanzen, "Das Europäische Währungssystem," November 8, 1978, BAK, B 126/70422.
[58] Hans Matthöfer an Helmut Schmidt, October 10, 1980, BAK, B 126/88640.

Washington's unwillingness to engage European concerns, however, made such a settlement unlikely. The establishment of the EMS ended the chance for a permanent transatlantic compromise about a replacement for Bretton Woods–the Europeans instead found a regional solution and further strengthened the European status as a robust challenger to American economic strength.[59]

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As Western European policymakers debated the content of the EMS in 1978, international confidence in the dollar continued to fall. Officials in Washington began to acknowledge that market forces alone might not fix the U.S. deficit and strengthen the dollar. In a memorandum in March 1978, Blumenthal warned Carter that continued decline in the dollar could have disastrous consequences for the international economy as well as political foreign policy objectives. The secretary pointed to the tensions and irritation on the other side of the Atlantic about U.S. policy, a development that threatened to "poison our foreign relations generally." OPEC held significant dollar-denominated assets, and Blumenthal feared that the oil producers would raise the price of oil to recover lost earnings. He also worried that the dollar depreciation projected weakness at home and hindered business confidence. "This perception feeds on itself and is dangerous," Blumenthal wrote. The Carter administration could not continue to pursue fast growth without recognizing the debilitating effects that such a program had on the dollar. In conclusion, Blumenthal advised the president, "<u>We must re-examine, and probably change fundamentally, our basic domestic economic strategy</u>."[60] The American trade

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[59] UKTSD paper, "The Outlook for the Dollar," August 31, 1978," UKNA, T 382/93. The Carter administration publicly supported the EMS, but many American officials privately expressed concern–a fact not lost on the Europeans. See, for example, Tammenoms Bakker aan MBZ, "U.S. Reaktie op Europees Monetair Stelsel," October 23, 1978, NNA, 2.06.107, 2035.

[60] W. Michael Blumenthal, "Memorandum for the President: Consequences of a Dollar Crisis (Draft)," March 14, 1978, NARA, RG 56, Chronological Files of Thomas Leddy, Deputy Director of the Office of International

deficit increased from $1.6 billion in June 1978 to $2.9 billion in July 1978 had a crippling effect on the dollar, and Acting Secretary of the Treasury Carswell warned Carter that representatives of foreign governments demanded publicly and privately that "only forceful measures to deal with inflation and reduce the trade deficit will save the dollar from further declines."[61] The British brokered a "package bargain" at the Bonn Summit in July 1978 in which Washington promised to reduce its deficit, and Bonn and Tokyo agreed to expand their economies.[62] This informal agreement, which some scholars have correctly hailed as the best example of multilateral management of the global economy, faltered quickly.[63]

The locomotive theory failed to produce results. Rather than make adjustments to accommodate expansionary American policies, the international community demanded that the United States impose restraint at home. The integration of national markets and the rise of the Euromarket had created more than $500 billion dollars of dollar-denominated assets in the hands of foreigners who could speculate against the dollar. Unless the owners of this capital were satisfied that the Carter administration had taken steps in house to fix the economy, the assault on the dollar would continue. Bergsten wrote Blumenthal in August 1978 that the market believed monetary policy was "no longer effective, fiscal policy moves as unlikely in the near future, and the anti-inflationary program as a failure. The market sees the Administration as resigned to await future developments, which may, over the horizon, be helpful but which offer no present incentive to hold dollars."[64] The echoes of British deliberations in the fall of 1976

Monetary Affairs, 1970-1979, TL Chron March-Apr. 1978, Box 6. The statement was underlined in the original document.

[61] "Memorandum From Acting Secretary of the Treasury Carswell to President Carter," August 30, 1978, FRUS, 1977-1980, vol. 3, Foreign Economic Policy (Washington, D.C.: United States Government Printing Office, 2013), doc. 158, 497.

[62] Denis Healey to James Callaghan, January 27, 1978, UKNA, T 382/84.

[63] See Brands, *Making the Unipolar Moment*; and Sargent, *A Superpower Transformed*.

[64] C. Fred Bergsten to W. Michael Blumenthal, "Foreign Exchange Market Conditions," August 14, 1978, NARA, RG 56, Bergsten, International Monetary, Box 2.

were clear. The Carter administration realized that it had to make policy changes at home. It could not rely on the normal business cycle to rectify imbalances.

The United States finally accepted responsibility to take domestic measures to stabilize the dollar. On October 24, 1978, Carter imposed voluntary price and wage controls and announced reductions to federal spending.[65] The markets continued to be bearish on the dollar believing that the action had been inadequate. A taxi driver in Frankfurt said, "I would rather not take any dollars at all. If somebody offered me dollars, I would drive him to the nearest bank to check the rate…I don't know what it's going to be tomorrow, do I?" One dollar purchased only 1.72 DM, an all-time low and a depreciation of more than 20 percent in a year.[66] After Carter's announcement, the yen rose 1.7 percent against the dollar, and the D-mark 1.8 percent.

The Carter administration had to do more. Blumenthal, Solomon, and other economic advisers presented the president with a new proposal on October 28, 1979, which Carter reluctantly accepted. On November 1, 1978, Carter announced a dollar "rescue package" that included a raise in the interest rate, a $30 billion intervention in the markets to support the dollar, and a drawing of $3 billion from the U.S. reserve tranche in the IMF. Robert Solomon, a former high-ranking official at the Federal Reserve, writes that Carter agreed to "swallow the bitter pill of a hike in interest rates" because he worried that other heads of state criticized him and a further slide of the dollar would hinder progress on fighting inflation.[67] At a Cabinet meeting later that month, Carter stated that "the problem of inflation was his most pressing concern."[68]

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[65] "White Paper: The President's Anti-Inflation Program," October 24, 1978, included as an attachment to a memorandum from Jack Watson to Cabinet Representatives, "The President's Inflation Program," October 24, 1978, NARA, RG 56, Subject Files of Anthony M. Solomon, U.S. Inflation, Box 2.
[66] Quoted in Silber, *Volcker*, 139.
[67] Solomon, *The International Monetary System 1945-1981*.
[68] "Minutes of the Cabinet Meeting," November 20, 1978, JCPL, CEA, Charles L. Schultze's Subject Files, Cabinet Meeting Minutes, '77-'78 [1], Box 8.

This time, the dollar rose seven percent against the D-mark, 7.5 percent against the Swiss franc, and 5 percent against the yen.

The Carter administration's program indicated the growing power of economic globalization to intrude on U.S. domestic policy. Seven years prior, President Richard Nixon had closed the gold window, demanding that the international community make adjustments to rectify the U.S. balance of payments. In November 1978, the logic was reversed–now foreigners demanded that Washington make changes to U.S. domestic policy.[69] The irony was that in the mid 1970s the United States worked with the IMF to attach strict conditionality for austerity measures in exchange for loans, most prominently in Britain in the fall of 1976. British policymakers had faced a choice: preserve government spending levels and withdraw from the global economy, or accept IMF assistance and implement an austerity program. Two years later, with the dollar rapidly depreciating, the United States faced the same dilemma. Just as Secretary of the Treasury William E. Simon insisted that Britain take significant steps to reduce its budget, foreign governments now demanded that the Carter administration rein in spending. The British IMF crisis precipitated a contentious argument in the Cabinet about whether Britain should turn its back on the international community, but to Carter's credit, no such debate occurred in late October 1978 in Washington. The Carter administration understood that American prosperity and strategic interests depended in part on a well-functioning global economy and took steps domestically to ensure that foreign holders of dollar-denominated assets retained confidence in the dollar. Now the international community forced the United States to make changes domestically, signaling that not even the United States was immune from the effects of economic globalization.

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[69] This interpretation aligns with that advanced by Sargent in *A Superpower Transformed*, 275-76.

Carter's announcement initially had the intended effect of reassuring the international community that the administration took its responsibility to defend the dollar seriously. The British embassy in Washington reported that although Carter's package of measures did not "remove all reasonable doubts," they made "the administration's policies look more coherent and vigorous."[70] The dollar quickly rebounded against the D-mark, yen, and Swiss franc. The progress, however, proved illusory. Inflation continued to climb and reached double digits by mid-March 1979. The second oil crisis contributed to the rise in prices; oil prices had risen by nearly 60 percent in 1979, a development that increased inflation and unemployment, production, and the balance of payments.[71] On July 15, 1979, Carter delivered a speech from the White House, remembering "when the phrase 'sound as a dollar' was an expression of absolute dependability, until 10 years of inflation began to shrink our dollar and our savings." The United States suffered from a "crisis of confidence," he said.[72] Two days later, Carter dismissed five of his cabinet members. Among those he fired was Treasury Secretary Blumenthal, whom Carter replaced with Federal Reserve Board Chairman G. William Miller.

With an eye on a solution to inflation, Carter replaced Miller with the conservative economist Paul Volcker. A figurative and physical giant in the field of economics, Volcker received his PhD in economics from Princeton University before moving to the private sector. He served at the Treasury as the undersecretary for monetary affairs in the early 1970s and was president of the New York Federal Reserve bank before returning to Washington. Carter did not know Volcker, but the latter had a well-earned reputation for being tough on inflation, and the

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[70] Peter Jay to FCO, "U.S. Economic Policy," November 3, 1978, UKNA, T 382/93.
[71] "Memorandum From the Under Secretary of state for Economic Affairs (Cooper) to Secretary of State Vance," August 7, 1979, FRUS, 1977-1980, vol. 3, doc. 225, 656.
[72] Jimmy Carter: "Address to the Nation on Energy and National Goals: 'The Malaise Speech,'" July 15, 1979. Online by Gerhard Peters and John T. Woolley, The American Presidency Project.

president thought he might be able to handle the problem. Carter later said, "I didn't really know whether Paul Volcker was a Democrat or Republic. I didn't care." During his first confirmation hearing before Congress in July 1979, Volcker emphasized price stability, contending that he did not "think we have any substitute for seeking an answer to our problems in the context of monetary discipline." When Volcker accepted the position, he first received a promise from Carter that the Federal Reserve's independence would be strictly observed. "Decisions on monetary policy are those of the Federal Reserve," he told Congress. "We have to call the shots as we see them."[73] The hard-nosed Volcker implemented policies to reduce inflation, believing that the Federal Reserve's inability to restrain the money supply bred inflation. On October 6, 1979, Volcker announced a stabilization program that would tighten the money supply–the Federal Open Market Committee (FMOC) would focus on managing the volume of bank reserves in the system rather than monitor the rate. This move prioritized discipline over economic growth and employment. An editorial in the *New York Times* labelled the decision as "Mr. Volcker's Verdun," comparing high interest rates to largest battle of the First World War. "By forcing interest rates to shoot up like a signal flare," the editorial read, "Mr. Volcker, like France's Marshal Pétain at Verdun, seeks to assure his own forces that the enemy 'shall not pass.' Marshal Pétain did hold the fort–at the cost of 350,000 casualties." Volcker thought that austerity was the only path to recovery and understood that people would suffer in the meantime. "There were no shortcuts," he lamented.[74]

Carter understood that the short-term effects of the Volcker program would hurt his chance for reelection. Unemployment increased from an average of 6 percent in 1977 to 7.8

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[73] Biven, *Jimmy Carter's Economy*, 238-39; Committee on Banking, Housing, and Urban Affairs, U.S. Senate, 96th Congress, 1st session, "Nomination of Paul A. Volcker," July 30,1979 (Washington, D.C.: U.S. Government Printing Office, 1979), 5-6.
[74] Quoted in *Silber*, Volcker, 178, 189.

percent in May 1980. Interest rates skyrocketed to an astounding 18.5 percent in April 1980.[75] The economy descended into a recession. Several prominent White House officials–particularly on the Council of Economic Advisers–opposed the severity of the program, but Carter gave Volcker his full support. The president believed that Volcker's policy was a necessary evil. Success in the global financial system largely turned on the performance of the United States, and if the country tried to preserve U.S. autonomy by erecting capital controls, the emerging neoliberal order would suffer.[76] This confirmed the logic of economic globalization: the health of the U.S. economy depended on the health of the global economy, and vice versa. Carter wrote in his diary, "This will hurt us politically, but I think it's the right thing to do."[77] The appointment of Volcker represented a remarkable act of political courage. Indeed, the recession played a vital role in Carter's defeat at the polls in November 1980, aggravating an existing sense of pessimism about America's future in the wake of the Iranian Revolution and Afghanistan War. It also marked the crucial junction that placed the country on the road to recovery, but nobody knew it quite yet.

[75] Patterson, *Restless Giant*, 148.
[76] Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca, NY: Cornell University Press, 1994), 135.
[77] Diary entry for September 25, 1980 in Jimmy Carter, *White House Diary* (New York: Farrar, Straus and Giroux, 2010), 468.

Chapter 7

“Solving the Puzzle”: Oil, Interest Rates, and the Recovery of Capitalism

When Jimmy Carter took office in January 1977, he inherited an unenviable economic situation. The accelerating interdependence of the global economy, high oil prices, currency instability, and inflation made domestic governance more difficult and less predictable than it had been in the early postwar period. Economic growth stalled and unemployment remained high across the industrial democracies. “No one has found the key to a return to high growth and employment at tolerable levels of inflation,” a member of the Policy Planning Staff in the U.S. State Department wrote in June 1978. “The great economic puzzle of the 1970’s remains unsolved.”[1] Carter gave a candid analysis of the broader implications of the economic situation in July 1979, admitting that the country suffered from “a crisis of confidence. It is a crisis that strikes at the very heart and soul and spirit of our national will…The erosion of our confidence in the future is threatening to destroy the social and the political fabric of America.”[2]

After 1983, however, the industrial democracies were in the midst of a recovery. Capital flooded into the United States, serving as the engine of sustained economic activity throughout the decade. U.S. growth reached 7 percent by 1984 and remained around 3-4 percent through the 1980s.[3] Drawing strength from the U.S. recovery, the Western Europeans and Japanese also emerged from the travails of stagflation. Inflation declined significantly and global capitalism

[1] Anton W. DePorte to Anthony Lake, “What Is Changing In Europe?,” June 15, 1978, National Archives and Records Administration (NARA), College Park, MD, RG 59, Records of Anthony Lake, 1977-1981, TL 7/1–7/15/78, Box 4.
[2] Jimmy Carter: “Address to the Nation on Energy and National Goals: ‘The Malaise Speech,’” July 15, 1979. Online by Gerhard Peters and John T. Woolley, The American Presidency Project. http://www.presidency.ucsb.edu/ws/?pid=32596.
[3] Hal Brands, *Making the Unipolar Moment: U.S. Foreign Policy and the Rise of the Post-Cold War Order* (Ithaca, NY: Cornell University Press, 2015), p. 177

enjoyed a period of steady growth. How did the industrial democracies finally "solve the puzzle"?

The turn to austerity provided the key. In this chapter, austerity refers to policies that decreased fiscal spending on social programs and lowered the standard of living. Austerity sacrificed the standard of living–permitting higher levels of unemployment and lower productivity levels in the name of macroeconomic stability–in order to satisfy debtors. The recession of the early 1980s, unemployment rates in the industrial democracies rose quickly, but inflation finally fell and high interest rates attracted capital to the United States that drove economic growth (and underwrote U.S. deficits). The United States stood at the center of the resurgence of capitalism, and its recovery stimulated the recovery of the other industrial democracies. As economic activity increased and the dollar strengthened, the Western Europeans and Japanese found more opportunities to export goods and expand growth in their own countries.

This chapter identifies two factors that led to the economic recovery. First, the second oil shock caused oil prices to rise sharply in 1979 and increased inflation at first, but it also unexpectedly played an important role in lowering inflation as the crisis wore on. Higher oil prices contributed to a recession, which limited consumption levels. The high prices made it more economical for the industrial democracies to pursue research into alternative sources of energy. Crucially, the second oil shock also coincided with the development of non-OPEC reserves of oil, notably in the North Sea, Mexico, and Alaska, that undercut high OPEC prices. OPEC could not sustain its high prices as its exports decreased in the face of decreased demand and increased competition from cheaper non-OPEC oil producers. The second oil shock eliminated a chief source of inflation and forced the Western world to limit oil consumption.

Second, high interest rates across the industrial democracies imposed discipline. Unlike the second oil shock, which developed due to circumstances in the international system, high interest rates were policy choices. Washington's acceptance of limits in the late 1970s was a chief contributor to a recession in the United States from 1979-1982, an economic contraction that finally lowered inflation and strengthened the dollar. The ability of the United States to draw capital from abroad accelerated growth. U.S. Federal Reserve Chairman Paul Volcker kept interest rates high to fight against inflation, and those high interest rates attracted foreign investors to place their money in U.S. debt. The Ronald Reagan administration incurred tremendous deficits, but capital from abroad offset those deficits. The British began the process of discipline during its IMF negotiations in 1976, and all the other industrial democracies would have to undergo a similar domestic adjustment in the early 1980s.

Although austerity reinvigorated liberal capitalism, it came at a high social cost. Policymakers increasingly believed that austerity was the only path to achieve stability in their countries. They did not want to reduce consumption and sacrifice their citizens' jobs, but they thought that the status quo was untenable. Maintaining high levels of government spending would destabilize the global economy, making future adjustments more painful. They believed that austerity would allow them to avoid a repeat of the 1930s, even if it came at a steep human cost in the short-term. Policymakers knew that these difficult decisions would be unpopular. In Detroit, radio stations played country music songs to cater to the unemployed listeners. The 1977 song "Take This Job and Shove It" was adapted to: "I Wish I had a Job to Shove."[4] Many leaders paid the price at the polls for their support of austerity. The recession was one of the chief reasons that Jimmy Carter lost his reelection bid in November 1980. Even Reagan suffered from

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[4] Greider, *Secrets of the Temple*, pp. 454-55.

continued support of high interest rates. American voters voiced their displeasure during the 1982 midterm elections, and the GOP lost 26 seats in the House to the Democrats. Austerity may have provided the solution to stagflation, but its implementation meant that people struggled during the recession.

In the larger sweep of international affairs, the turn to austerity occurred concurrently with the inauguration of the so-called "second Cold War." The collapse of détente and the resurgence of the East-West conflict once again placed Western relations with the Soviet Union at the forefront of world politics and escalated tensions to a level that had not existed since the Cuban Missile Crisis. The Soviet invasion of Afghanistan and the Iranian Revolution dominated the newspapers and have since dominated the historiography of the period. Many scholars correctly contend that the focus of the Carter administration shifted to Cold War priorities by 1978, but the literature tends to ignore Carter's continued engagement with the challenges of international economic affairs.[5] Even as tensions rose, the Cold War did not singularly define the challenges of a complex world, and the trials of economic globalization did not disappear.

Furthermore, the collapse of détente once again raised the specter of nuclear war, but they

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[5] This argument pushes back against the dominant line in the historiography that portrays Jimmy Carter as entering the White House with the idealistic objective of transcending the Cold War and engaging instead "world order politics," only to pivot back to containment by 1978. Explanations for the pivot include Carter's failure to gain domestic support for his policies, disagreement between Carter's foreign policy advisers, and Washington's perception of threat regarding developments in the Third World. For a sample of this literature, see Raymond L. Garthoff, *Détente and Confrontation: American-Soviet Relations from Nixon to Carter* (Washington, D.C.: Brookings Institution, 1994); Scott Kaufman, *Plans Unraveled: The Foreign Policy of the Carter Administration* (DeKalb: Northern Illinois University Press, 2008); Gaddis Smith, *Morality, Reason & Power: American Diplomacy in the Carter Years* (New York: Hill & Wang, 1986); Odd Arne Westad, *The Global Cold War* (New York: Cambridge University Press, 2007); and Barbara Zanchetta, *The Transformation of American International Power in the 1970s* (New York: Cambridge University Press, 2014). Daniel J. Sargent takes a more nuanced approach, contending that increased tensions with the Soviet Union caused the Carter administration to abandon its goal of transcending the Cold War. "Still, what unfolded during 1979-80," Sargent argues, "was not a sharp pivot so much as a diffusion of the administration's initial focus on post-Cold War priorities and an assimilation of Cold War commitments centered on Brzezinski's 'arc of crisis' into world order priorities." See Daniel J. Sargent, *A Superpower Transformed, The Remaking of American Foreign Relations in the 1970s* (New York: Oxford University Press, 2015), p. 291.

illuminate very little about why the Cold War ended as it did. The outcome of the Cold War was not certain in the 1970s, in large part because its ability to emerge from stagflation was by no means clear. A fundamental premise of this chapter (and indeed of the larger dissertation) is the fact that the West eventually mastered economic globalization (and the East did not) played one of the decisive roles in precipitating the end of the Cold War the following decade. Cold War flashpoints and tensions destroyed détente, but the Western triumph over the economic crises proved more consequential in dictating the outcome of the Cold War than heightened tensions between Washington and Moscow. In an ideological competition between two ways of life, a healthy economy was central to both the West's and East's ability and moral authority to wage the Cold War. This chapter examines how the industrial democracies reluctantly embraced austerity as a strategy to master the challenges of economic globalization and reinvigorate capitalism's attractiveness as a way of organizing political economy.

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The second oil crisis, precipitated by the Iranian Revolution, played a leading role in the onset of the recession and lowering inflation. The crisis emerged from factors that had led to the first oil crisis in 1973: industrial democracies' dependence on foreign oil (particularly in the Middle East), high consumption rates, and few alternative sources of energy. High oil prices had become a fact of life in the West and elsewhere in the 1970s, and they signaled a new constellation of power in the oil trade. OPEC accounted for 62 percent of oil production in the free world in 1973 and 62 percent in 1978.[6] U.S. Secretary of Energy James Schlesinger said in June 1977 that "the closing of the frontier in 1890 was in some sense a shock to the American system. And similarly, as we face a future with constraint in the area of oil and gas, we are going

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[6] Yergin, *The Prize*, p. 647.

to have a similar transition for the American society to go through."[7] U.S. consumption grew substantially in the 1970s and the volume of imports from the Middle East caused international concerns about dependence on OPEC as well as its effect on the stability of the international monetary system. Nevertheless, just as the chaos in the international monetary system had unintended long-term benefits for the West, so too did the oil crisis. Climbing prices stimulated the investment of massive amounts of capital into new sources of oil that would loosen the OPEC's grip on the industrial democracies, and the crisis also contributed to a recession that finally limited oil consumption in the United States. Rather than lead to an ever-increasing windfall of profits for OPEC, the crisis triggered a collapse of oil prices in the early 1980s and created a glut in the market–removing one of the most significant inflationary forces in the global economy.

The proximate cause of the crisis lay in events in Tehran. Emboldened by the flow of petrodollars into Iran, Reza Shah Pahlavi had embarked on an ambitious military buildup and a Western-style modernization program to become the predominant power in the Persian Gulf–the so-called "White Revolution." The United States considered Iran one of the "twin pillars" in the American strategy for the Middle East, a proxy for the U.S. policy of containment of the Soviet Union. Wanting to preserve geopolitical dominance in the oil-rich region, the U.S. leadership allowed Iran to purchase military weapons and equipment to strengthen Iran's position.[8] Furthermore, with the rise of oil prices after the October War, Washington welcomed military sales to Iran as a means of reclaiming the capital that had been spent on higher oil prices.

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[7] "Remarks of James R. Schlesinger before the Chamber of Commerce of the United States of America," June 24, 1977, JCPL, Council of Economic Advisors, Charles L. Schultze's Subject Files, [Energy][2], Box 25.
[8] For an examination of the Carter administration's view of Iran's value to the United States shortly before the revolution, see Cyrus Vance to Jimmy Carter, "Visit of the Shah and Shahbanou, November 15-16," November 10, 1977, JCPL, NSA, Brzezinski Material, VIP Visit File, Iran, Shah, 11/15-16/77, Box 5.

Tehran's close association with Washington, however, was a liability for the regime. Critics viewed the shah as a puppet of the CIA, which had installed him with British assistance in a *coup d'etat* in August 1953. Opposition to the shah grew in earnest in the 1960s as protesters denouncing the autocracy of the regime, decentralization of Shi'ism as a guiding ideology, and corruption. In the late 1970s, massive oil revenues offered an opportunity to solve the country's problems, but skyrocketing inflation and an unwillingness to spend money on social developments meant that 30 percent of the country was unemployment and many felt alienated from the mission of the White Revolution, a program from which they did not benefit. A middle manager or a civil servant in the Iranian capital had to spend up to 70 percent of his salary on rent alone.[9] Protests erupted in cities across the country, and the cleric Ayatollah Ruhollah Kohmeini emerged as a leader of the opposition that envisioned an Iran based on Islam.[10]

Strikes in the oil fields began in October 1978 as Iranian workers rebelled against the Oil Service Company of Iran (Osco)–a consortium of 14 foreign companies. Disruption of production followed immediately. Most of the Iranian crude oil was located in the Khuzestan, an area of more 25,000 square miles in southwestern Iran; 90 percent of the oil then flowed through Kharg Island before being shipped overseas.[11] Iran was the second-largest exporter of oil (behind Saudi Arabia) with a total of more than 5.5 million barrels per day (bpd), but by mid-November, that figure had fallen to fewer than 1 million bpd. Beginning on December 26, 1978, Iranian oil

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[9] Yergin, *The Prize*, p. 656.
[10] For a synopsis of the causes of the Iranian Revolution, see Amin Saikal, "Islamism, the Iranian Revolution, and the Soviet Invasion of Afghanistan," in *The Cambridge History of the Cold War, Volume III: Endings*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), pp. 112-21. On the broader origins and consequences of the Iranian Revolution, see Michael Axworthy, *Revolutionary Iran: A History of the Islamic Republic* (New York: Oxford University Press, 2013). On U.S. relations with Iran, see Kenneth M. Pollack, *The Persian Puzzle: The Conflict Between Iran and America* (New York: Random House, 2004); and Zanchetta, *The Transformation of American International Power*, pp. 243-70.
[11] "Vulnerability of the Iranian Oil Production and Export System: A Preliminary Assessment," December 5, 1978, NARA, RG 59, Records of Anthony Lake, 1977-1981, Iran–Misc.–Nov. '79 + prev., Box 19.

production ceased completely and did not recommence for 69 days.[12] Exports resumed in March, but only at a level of about 3 million bpd. The disruption of oil shipments hit the industrial democracies hard, particularly the Netherlands, Spain, Japan, Canada, and Britain – countries with dependencies on Iranian oil ranging from 16-36 percent.[13]

The outbreak of the second oil crisis gave policymakers and populations in the industrial democracies a sense of *déjà vu*. Panic gripped nervous civilians as they feared a repeat of the chaos that the oil disruptions of 1973-1974 had unleashed on the Western world. The average sale of gas in the United States fell from eight gallons to three.[14] The loss of Iranian oil on the world market represented a reduction between four and five percent of total supply, but prices rose from $12 to almost $40 per barrel between 1978 and late 1979. The prices rose steeply because oil companies and traders feared a repeat of the shortages in 1973-1974, and they bid up oil prices on the spot market as they scrambled to secure supplies. Looking back at the crisis, the British Department of Energy noted that "the oil market is very dependent on perceptions." Even though the price increases of 1979 took place in the context of an excess of supply over demand by about one million bpd, the market reacted because it feared "a possible permanent change for the worse."[15] Sensing an opportunity, OPEC raised the posted price by 14.5 percent in December 1978 with an additional 9 percent in March 1979. The crisis turned on the price of oil, not supply. Saudi Arabian Oil Minister Sheikh Yamani advocated moderation, fearing that the price increases would trigger a global recession, but his counterparts in OPEC overruled him.[16]

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[12] Yergin, *The Prize*, pp. 660-62.
[13] "Paper Prepared in the Department of State," undated, FRUS, 1969-1976, vol. 37, Energy Crisis, 1969-1976 (Washington, D.C.: United States Government Printing Office, 2011), doc. 166, p. 526.
[14] Jacobson, *Panic at the Pump*, p. 207.
[15] Paper by Department of Energy, "Reduction in Oil Supplies Since the Iranian Revolution: Lessons for the West," December 29, 1980, UKNA, FCO 8/3762.
[16] Sargent, *A Superpower Transformed*, p. 277-78.

The crisis occurred at a particularly inopportune time for the West. An American official warned that the price increases "threaten[ed] to turn weak growth and high inflation in all the industrial countries into recession and to deeply ingrain inflationary expectations."[17] The first oil crisis had catastrophic implications institutions and economies across the globe, and policymakers feared the ramifications of further upheaval. "The problem is going to be how the world can provide sufficient employment and curb inflation with virtually no prospect of an increase in the supply of oil in the short term regardless of price," Widman wrote Bergsten in November 1979. "All else is going to be subsidiary."[18]

Recalling the division in the West during the first oil crisis, State staffer Karin Lissakers warned Vance that the current crisis had the potential to precipitate "a politically divisive scramble among the major industrial countries for scarce oil supplies."[19] Henry Kissinger had forged a cooperative strategy in 1973-1974 based on consumer solidarity, energy conservation, and the production of domestic sources of energy as a means of maintaining the cohesion of the West, and the events of 1978-1979 put his legacy to the test. Economic interdependence had only increased since the first oil crisis, and the situation required a concerted effort, regardless of national positions. "This is an international problem, which needs an international solution," the British Department of Energy concluded. Although the British were cushioned by new production in the North Sea, they recognized that the "maintenance of normal trade patterns" was as much in the British "interest as it is in [the other industrial democracies']."[20] An agreement in the International Energy Agency stipulated that if a member's supply of oil

[17] George Eads to Charles Schultze, "Recent Oil Price Increases by Lybia [sic], et al," October 18, 1979, JCPL, Charles L. Schultze's Subject Files, Oil Prices [2], Box 62.
[18] F. Lisle Widman to C. Fred Bergsten, "State-Treasury Lunch," November 19, 1979, NARA, RG 56, Subject Files of Anthony M. Solomon, Economic Summit (Current), Box 1.
[19] Karin Lissakers to Cyrus Vance, "Suggestions for an International Oil Policy," June 5, 1979, NARA, RG 59, Records of Anthony Lake, 1977-1981, TL 6/1-15/79, Box 5.
[20] Note by Department of Energy, "The UK Oil Supply Situation," May 25, 1979, UKNA, T 370/1138.

decreased by seven percent, it would trigger a clause that required the rest of the organization to share supplies.

The oil shock contributed to a general sense of gloom in the West. The first Secretary of Energy James Schlesinger observed, "The closing of the frontier in 1890 was in some sense a shock to the American system. And similarly, as we face a future with constraint in the area of oil and gas, we are going to have a similar transition for the American society to go through."[21] Carter's subsequent decision to replace many key advisers in the Cabinet did not convey confidence either. The president understandably took heat from the press and pundits for the economic woes–policies of restraint and sacrifice are rarely popular. Nevertheless, the industrial democracies were better prepared to handle the ramifications of the Iranian oil disruptions in comparison to the price hikes of 1973. Through a combination of domestic measures, some of the industrial democracies had been able to reduce the amount of energy they consumed while others had slowed annual increases. From 1969 to 1973, for example, Britain's energy consumption increased 4.7 percent per year, but from 1974 to 1978 it declined 3.2 percent. France, Italy, West Germany also achieved yearly reductions. U.S. and Japanese consumption increased, but only 0.4 and 1.8 percent per year, respectively.[22] OPEC's surplus dropped after the end of 1976; by 1978, it lay at $11 billion–a figure dwarfed by the Japanese surplus of $16.6 billion.[23]

The industrial democracies pursued a three-pronged strategy. First, the "most urgent" task was to stop the frantic bidding on the spot market that drove up prices and bred panic. The

[21] "Remarks of James R. Schlesinger before the Chamber of Commerce of the United States of America," June 24, 1977, JCPL, Council of Economic Advisors, Charles L. Schultze's Subject Files, [Energy][2], Box 25.
[22] CIA paper, no title, June 15, 1979, JCPL, NSA, Brzezinski Material, Economic Summit Background Papers Book III, 6/28-29/79, Box 23.
[23] GL 42 an Helmut Schmidt, "Entwicklung und Kontrolle der Euromärkte," February 5, 1979, BAK 136/11547.

average OPEC price per barrel was about $17 in June 1979 (31 percent higher than in December 1978), but prices on the spot market ranged from $25-35 per barrel and even reached $50 in some cases. How to bring down the prices, however, divided the major industrial democracies. The issue turned on how involved the central governments should be in the oil market. The Carter administration believed that only a concerted effort among the countries with major oil companies could control the spot market, preventing their companies from purchasing oil above OPEC prices. France supported this tactic and requested that the European Community intervene in the Rotterdam market to stop bidding above the official price.[24] West Germany, in contrast, believed that the market would correct itself. "Regulation of the spot market and multilateral allocation of supplies would not work in the long-term," Schmidt told Carter in June 1979.[25] Spot prices eased in the summer of 1979 after the Saudi Arabians agreed to increase production.

Second, U.S. and Western European policymakers understood that a solution to the oil shock depended in large part on the cooperation of Saudi Arabia, just as it had in 1973-74. Lissakers wrote that Saudi Arabia represented the only swing producer "with the spare capacity to provide significant immediate relief on the supply side."[26] Since late December 1978, Saudi Arabian production increased to about 10.5 million bpd, a number about 2 million bpd higher than usual. Other members of OPEC, particularly Kuwait and Iraq, also increased production to take advantage of higher prices, and Iran recommenced oil shipments in early March, albeit at a lower level than before the revolution. Saudi Arabia, however, was the key to satisfying global demand. U.S. policymakers feared that Saudi Arabian output might decline–Riyadh had imposed

[24] Karin Lissakers to Cyrus R. Vance, "Suggestions for an International Oil Policy," June 5, 1979, NARA, RG 59, Records of Anthony Lake, 1977-1981, TL 6/1-15/79, Box 5.
[25] "Vermerk über die Delegationssitzung am 6. Juni 1979, 13.00 Uhr," June 6, 1979, BAK, B 136/16809.
[26] Karin Lissakers to Cyrus R. Vance (through Anthony Lake), "Suggestions for an International Oil Policy," June 5, 1979, NARA, RG 59, Records of Anthony Lake, 1977-1981, TL 6/1-15/79, Box 5.

a ceiling of 8.5 million bpd since 1974, but the Iranian crisis forced the Saudi Arabians to balance this self-imposed limit with their stated goal to meet the world's oil needs. The Saudi Arabians also were sensitive to the effects of higher prices on the global economy, but they did not to break ranks with their fellow OPEC members publicly. Thus, overtures to Riyadh needed to be made discreetly so as not to embarrass Saudi Arabia.[27]

The Saudi Arabians opposed severe price hikes because they threatened to destabilize the global economy, but they also did not want to bear the sole burden of solving the crisis. Saudi Finance Minister Mohammed Ali Abalkhail told West German Economics Minister Otto Graf Lambsdorff in February 1979 that Saudi Arabia was ready to "do its share" to cover the Iranian shortfall, but it would not do so alone. Furthermore, Abalkhail stressed that the OECD-countries must make a fundamental contribution to the situation by committing themselves to energy conservation measures.[28] Carter's initiative to convene a peace conference with the Arabs and Israelis, however, complicated matters for Riyadh. The Camp David Accords in September 1978 brokered a bilateral "peace for land" agreement between Israel and Egypt, whereby Israel withdrew from the Sinai in exchange for Egypt signing a formal treaty in March 1979. This reversed the dynamics of 1974, when Kissinger leveraged progress toward an Arab-Israeli settlement as a source of pressure on Saudi Arabia. Important issues endemic to the broader Arab-Israeli conflict remained unresolved, notably the future of the Israeli-occupied West Bank and the fate of Palestine.[29] The rest of the Arabs denounced the treaty, and Saudi Arabia balked

[27] "Action Memorandum From the Assistant Secretary of State for Economic and Business Affairs (Katz) to the Unver Secretary of State for Economic Affairs (Cooper)," January 15, 1979, FRUS, 1969-1976, vol. 37, doc. 182, pp. 583-87.
[28] Die Leiterin der Abteilung V, "Vermerk über das Gespräch zwischen BM Graf Lambsdorff und dem saudischen Finanzminsiter Abalkhail beim Mittagessen am 1.2.1979," February 1, 1979, BAK, B 102/281038.
[29] Douglas Little, "The Cold War in the Middle East: Suez Crisis to Camp David Accords," in *The Cambridge History of the Cold War, Volume III: Endings*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), pp. 323-24.

at moving too close to the United States. A Shell representative told British officials that the Saudis understood the economic arguments that the West made for increasingly oil production, but they "were not prepared after Camp David to allow themselves to be seen to be the friends of the United States."[30] The Saudi Arabians lowered their production back to the self-imposed 8.5 million bpd ceiling in April 1979.

The fifth G7 Summit in Tokyo in late June 1979 provided a forum for the industrial democracies to convince Riyadh that they were serious about energy conservation. Concerns about energy dominated the summit agenda as the members debated how to restrain oil consumption and increase domestic production. The members of the International Energy Agency had pledged in early March 1979 to reduce oil consumptions by five percent, and the seven heads of state now vowed to reduce their nation's oil imports through 1985. The European countries promised to restrict the Community's imports to 9.4 million bpd (the 1978 level), the United States to a level of 8.5 million bpd, and Japan to about 6.5 million bpd.[31] Western European behavior at the Tokyo Summit comported with the move toward a European bloc in international affairs: Britain, France, Italy, and West Germany wanted to be treated as a group rather than individual nations. They did so because then the Community could absorb the growing oil production from the North Sea and not count it as imports. The communiqué at the summit also vaguely outlined a joint commitment to develop alternative energy sources, particularly coal and nuclear power.[32] As a result, Saudi Arabia indicated in early July 1979 that it would increase production. American officials credited themselves for this decision, believing that Carter's "success at Tokyo" in enacting energy conservation and production policies that

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[30] "Note of a Discussion Over Dinner at Chequers on Saturday, 16 June 1979," UKNA, PREM 19/42.
[31] "Realities of the Oil Business," *Petroleum Economist*, vol. 46, no. 8 (August 1979), p. 311.
[32] A copy of the communiqué can be found in UKNA, PREM 19/27.

resonated with Riyadh.[33] As scholar Meg Jacobson writes, "[a]s quickly as they had appeared, the [gas] lines evaporated."[34]

The third element of the Western strategy included increased produced in alternative sources of energy. Once again, OPEC had shown itself to be an unreliable source of energy. "The essential lesson to be drawn from events in the Middle East in 1979 and 1980," the British Department of Energy concluded, "is that the West will remain vulnerable even to quite small supply disruptions until its dependence on imported oil is greatly reduced."[35] The oil crisis led to a scramble to find alternative energy sources. Unlike 1973, however, the industrial democracies had success. Fueled by new sources of oil, global production in the year of crisis–1979–exceeded that of 1978. Together, new sources of oil supplies undermined OPEC's hold on the West.

Britain was the most dramatic example. The loss of Iranian exports hit Britain the hardest; because of British Petroleum's historical position, the country depended on Iran for almost 40 percent of its supplies. Fortunately, the second oil crisis coincided with accelerated development of reserves in the British sector of the North Sea. In 1980, the British Foreign Office estimated that it had between 2.4 billion and 4.4 billion tons of oil reserves. Britain attained oil self-sufficiency by June 1979, producing 7.069 million tons that exceeded a total consumption of 6.168 million tons.[36] Buoyed by the accelerated development of the North Sea, oil production in Western Europe increased 29 percent in 1978, reaching a total of 83 million

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[33] "Memorandum From Henry Own of the National Security Council Staff to President Carter," July 9, 1979, FRUS, 1969-1976, vol. 37, doc. 225, p. 717.
[34] Jacobson, *Panic at the Pump*, p. 235.
[35] Paper by Department of Energy, "Reduction in Oil Supplies Since the Iranian Revolution: Lessons for the West," December 29, 1980, UKNA, FCO 8/3762.
[36] "News in Brief," *Petroleum Economist*, vol. 46, no. 10 (October 1979), p. 435.

tons.[37] Production in the North Sea did not make a large dent in the global oil market–it constituted only about three percent of production in the free world and matched five percent of total OPEC production–but it did shelter British financial reserves from the effects of the crisis.[38]Although production from the North Sea cushioned the blow of the oil shock for the British, it did not insulate them completely. British reserves were not inexhaustible, and Thatcher told Giscard that North Sea oil would provide Britain with an energy solution for 15-20 years.[39] "We are not Saudi Arabia, or even Norway," FCO staffer Kenneth Couzens wrote.[40] Britain's dependence on a smoothly functioning global economy gave it a strong interest in resolving the crisis, and Britain suffered from "the macroeconomic consequences of massive price increases," including lost growth, inflation, and unemployment.[41]

The recent discovery of large oil and natural gas reserves in Mexico could make a significant change in the world energy market, contributing valuable supplies and serving as a restraining mechanism on prices. Production had accelerated after the first oil crisis, and daily output rose from 500,000 barrels in 1972 to 1.9 million in 1980–an increase of almost 400 percent in less than a decade.[42] The White House predicted that Mexico would be among the leaders in energy within a decade, producing at a level approximately equivalent to Iran. Aside from the benefit of additional supply, Mexico's geography played to Washington's advantage. Imports from Mexico would be free from the military and political vulnerabilities that affected

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[37] Donald O. Cross, "Competition Cuts 1978 OPEC Output," *Petroleum Economist*, vol. 46, no. 1 (January 1979), p. 5.
[38] "Foreign Policy Implications of the UK's New Position as an Oil Exporter: Draft Paper by FCO," January 11, 1980, UKNA, FCO 96/1041.
[39] "Record of the Prime Minister's Conversation With President Giscard d'Estaing at the Elysee in Paris on 5 June 1979 at 1110," UKNA, FCO 33/3956.
[40] Kenneth Couzens to Horst Schulman, December 14, 1979, UKNA, FCO 96/910.
[41] Paper by Department of Energy, "Reduction in Oil Supplies Since the Iranian Revolution: Lessons for the West," December 29, 1980, UKNA, FCO 8/3762.
[42] Yergin, *The Prize*, p. 649.

the security of imports beyond the Western Hemisphere. The Middle East supplied 21 percent of American oil imports in 1975, but that number climbed to 40 percent by the end of 1978 and U.S. officials believed that that figure would continue to grow. The United States was the only realistic large market for Mexican energy exports because of a shared border, and an energy relationship between the two countries represented a mutually attractive option.[43]

Nuclear power also offered an avenue away from dependence on oil. Here, France took the lead. France grew to be the second largest nuclear power (after the United States). Energy Commission Director Pierre Despairies announced Paris' intention to cut the share of oil in domestic energy use from 58 percent in 1978-79 to 45 percent by 1985. This meant that French oil imports would decrease by 80 million tons of oil by 1985. While France had no significant reserves of oil to exploit, it took advantage of its vast reserves of uranium to loosen OPEC's grip on its energy supply.[44]

Although the level of dependence on OPEC declined, the second oil crisis demonstrated again that the Middle East was a region of first-order importance to the United States and Western Europe. The Soviet invasion of Afghanistan in December 1979 marked the death knell of détente, and its portentous implications for Western oil security loomed large in the minds of policymakers. Having endured a second oil crisis, Washington, for example, feared what the presence of the Red Army so close to the Strait of Hormuz would mean for the industrial democracies' access to oil. Soviet soldiers could march into the Middle East and seize control of the area, a region that held two-thirds of the world's exportable oil. With the recent upheaval of

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[43] "Paper Prepared by the National Security Council Staff," November 22, 1978, FRUS, 1969-1976, vol. 37, doc. 170, pp. 543-50.

[44] Doris Leblond, "Taking the Lead in Nuclear Power," *Petroleum Economist*, vol. 47, no. 2 (February 1980), p. 52-54. On the debates about nuclear power in the United States, see J. Samuel Walker, "The Nuclear Power Debate of the 1970s," in *American Energy Policy in the 1970s*, ed. by Robert Lifset (Norman, OK: Oklahoma University Press, 2014), pp. 221-54.

1979 fresh in his mind, fear of Soviet aggression shaped Carter's reaction to the Afghanistan War. The president told the American people that "an attempt by any outside force to gain control of the Persian Gulf region will be regarded as an assault on the vital interests of the United States of America, and such an assault will be repelled by any means necessary, including military force."[45] This policy marked what would become known as the Carter Doctrine. The possibility of further Soviet encroachment into the Gulf provided yet another impetus for the industrial democracies to reduce its oil dependence on a vulnerable region.[46]

The Soviet invasion of Afghanistan did not, however, trigger a broader plot to move into the Middle East. Nor did fears that OPEC's surplus would be measured in the trillions of dollars come true. In fact, the international energy situation stabilized somewhat by mid 1980. Supplies met global demand and spot prices had reduced, even though Iranian production remained below pre-revolution levels. Countries hoarded oil to deflect the effects of further disruptions; the world had learned to function without Iranian oil.[47]

The effects of the outbreak of war between Iraq and Iran in late September 1980, however, portended further trouble for the oil market. The war immediately withdrew about four million bpd from the market–about eight percent of demand in the industrial democracies. Spot prices reached up to $42 per barrel–the highest price to that date.[48] Fighting concentrated initially in the region of Shott-al-Arab–an area in the path of oil tankers on their way west. Some analysts feared that the militarily disadvantaged Iranians would move to block the crucial Strait of

[45] Leffler, *For the Soul of Mankind*, pp. 335-36.
[46] "Overall Strategy for Coordinated Response to Afghanistan," February 22, 1980, NARA, RG 59, Records of Anthony Lake, 1977-1981, TL 2/16-29/80, Box 6.
[47] Abteilung 4, "Irakisch-iranischer Grenzkonflikt: Auswirkungen auf die Ölmarkte," September 23, 1980, BAK, B 102/281237.
[48] Yergin, *The Prize*, p. 693.

Hormuz, the embarkation point for oil on its way to the West.[49] As the second-leading producer in OPEC, Iraqi oil fields yielded 180 million tons per year–a figure that represented five percent of global production. Of this total, 60 million tons went to the European Community (11.5 percent of oil imports).[50] France and Italy imported the most from Iraq among the European nations, with dependencies of 23 and 17 percent, respectively.[51]

The Western response to the conflict underlined the changing dynamics of the oil market. From the perspective of energy, the most striking thing about the Iran-Iraq War was that it did not cause a third oil crisis. The industrial democracies escaped another crisis for several reasons. First, Saudi Arabia continued its high rate of production and managed to compensate for the loss of Iran and Iraq on the oil market. Other producers such as Britain, Mexico, and Norway increased their output as well. For the first time, non-OPEC production outpaced OPEC production. Second, the recession had already begun, and people were less inclined to spend money on expensive gas. The oil shock decreased demand and conservation efforts succeeded. The share of oil in total energy consumption in the industrial democracies declined from 53 percent in 1978 to 43 percent in 1985.[52]

The seemingly inexorable march of the industrial democracies during the twentieth century toward energy dependence on the Middle East stopped in the aftermath of the second oil crisis. After 1981, oil prices began to steadily decline until 1985, when they crashed. The hold of OPEC on the oil market came under assault from other sources of oil, particularly from the North Sea (which outproduced Algeria, Libya, and Nigeria combined – with more to come). New

[49] "Drop in Oil Supply From Iraq Emerges as Greatest Threat to West in Conflict," September 24, 1980, *New York Herald Tribune*.
[50] Referat IIIC2, "Auswirkungen einer möglichen Unterbrechung der irakischen Öllieferungen" September 23, 1980, BAK, B 102/281237.
[51] European Community Department paper, "Essential Facts," October 6, 1980, UKNA, FCO 96/1044.
[52] Yergin, *The Prize*, p. 700.

producers entered the trade in the spot market, and they undercut more expensive OPEC oil. Yamani, who had long served as a moderate voice in OPEC, told his counterparts, "Our price is too high in relation to the world market." In March 1983, OPEC slashed prices by 15 percent–the first time that it ever did so. OPEC remained a major player in the oil market, but its days of dictating the terms of the market had ended. For the industrial democracies, this meant that a prime source of inflation disappeared.[53]

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A sharp recession hit the industrial democracies in the early 1980s. It led to low growth rates, a decrease in world trade, and the rise of unemployment rates to levels that had not existed since the Great Depression. The recession, however, proved to have unforeseen benefits. As noted above, the spike in oil prices contributed to the onset of the recession, which in turn helped lower oil consumption and made production of alternative sources of energy more economical. In addition, high interest rates across the industrial democracies contributed to the global recession, but they also served to lower inflation and attracted capital from abroad that would serve as the engine for the economy recovery by 1983.

Scholars have given the Ronald Reagan administration credit for lifting the United States out of the economic malaise of the 1970s, an interpretation that Reagan himself encouraged. During the 1980 presidential election, Reagan often ridiculed Carter's economic policies and enjoyed telling his supporters: "A recession is when your neighbor loses his job, a depression is when you lose your job, and recovery is when Jimmy Carter loses his."[54] In his memoirs, Reagan boasted that at the G-7 Summit in Williamsburg, Virginia in May 1983, he and the other six

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[53] Yergin, *The Prize*, pp. 700-02.
[54] James T. Patterson, *Restless Giant: The United States from Watergate to Bush v. Gore* (New York: Oxford University Press, 2005), p. 148.

heads of state sat around a table and West German Helmut Kohl requested that the president "tell us about the American miracle." In response, Reagan "launched" into a familiar speech to a fawning audience, crediting tax reductions in the United States for generating economic growth and increasing government receipts.[55]

Reagan receives much of the credit for the recovery in the United States, but the recovery actually proceeded *despite* his policies. Upon assuming office, Reagan sought to rejuvenate the economy through enormous tax cuts. He embraced supply-side economic policies, which posited that tax reductions would allow Americans to retain income, giving them an incentive to create even more wealth. Increased economic growth would also lead to higher tax revenues for the state. The president coupled the tax breaks with an expensive military build-up that he believed would win the Cold War. His budget strategy–tax cuts for the wealthy and military spending–formed the heart of what would become known as Reaganomics, an economic program that tripled the national debt between 1980 and 1989 (from $914 billion to $2.7 trillion). Reagan added more to the national debt in six years than all presidents combined in the previous 190 years.[56] "We who were going to balance the budget face the biggest budget deficits ever," Reagan wrote in his diary in December 1981.[57] Director of the Office of Management and Budget David Stockman later wrote that by 1982, "the fiscal situation was an utter, mind-numbing catastrophe."[58] Spending on a huge military buildup combined with tax cuts in an age of deflation severely increased inequality and debt. Although Reagan ran on a platform of a small federal government, he raised military spending and did not significantly challenge

[55] Reagan, *An American Life*, p. 351.
[56] Kunz, *Butter and Guns*, p. 286
[57] Diary entry for December 8, 1981, in Douglas Brinkley, ed., *The Reagan Diaries* (New York: Harper Perennial, 2007), p. 53.
[58] David Stockman, *The Triumph of Politics: How the Regan Revolution Failed* (New York: Harper & Row, 1986), p. 356.

spending on social services such as social security and Medicare. Stockman admitted, “What economic success there was had almost nothing to do with our original supply-side doctrine.”[59]

To his credit, Reagan gave unwavering support to Volcker’s harsh policies that had begun under Carter, allowing the country to take the full course of Volcker’s prescription. The new president supported Volcker despite a level of unemployment that averaged 9.7 percent in 1982, the highest since the Great Depression.[60] Nevertheless, Reagan understood that inflation undermined economic growth.

High interest rates did more than just lower inflation; they also served to attract foreign investment in the United States. The influx of capital from abroad funded these new American deficits, providing cover for the failings of Reaganomics. Volcker disapproved of the administration’s climbing budget deficits, but he and his staff understood that high interest rates could offset them by attracting foreign investors to the United States. Even though the economy began to recover, Volcker kept interest rates high, refusing to allow the executive branch and Congress to count on inflation to counteract the deficits. Vice Chairman Preston Martin explained: “We have to have rates high enough to bring in the capital. All of us have to consider the government financing very seriously….[K]eeping the rates high enough to attract foreign investors is the argument that’s made and it’s an awareness we all had.” Governor J. Charles Partee added, “We let conditions exist that made the U.S. interest rates look favorable compared to foreign investments. We stayed above the foreign interest rates so the foreign investors would be attracted to the U.S.” In particular, they wanted to ensure that the Japanese were buying government debt. As William Greider notes, “Real interest rates, guided by the Federal Reserve’s money-supply policy, became the steering mechanism for its control over the nation’s

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[59] Ibid, p. 377.
[60] Patterson, *Restless Giant*, pp. 155-58.

economic expansion. Given the bizarre conflict between monetary and fiscal policy, the extraordinary real rates would attract ample capital to finance the debt." The real rate of interest on twenty-year Treasury bonds, for example, averaged 0.6 percent during 1979; by the end of 1983, it had climbed to 8.4 percent.[61]

Similar to the recycling of petrodollars after the 1973 oil shock, the astounding amount of capital that poured into the United States greased the wheels of America's recovery, changing the U.S. economic relationship with the rest of the world. $83 billion flowed into the United States in 1983, $103 billion in 1984, $129 billion in 1985, and $221 billion in 1986.[62] As Charles Maier has argued, the United States emerged from the malaise of the 1970s as a transformed superpower. It had risen to power as an "empire of production" in the nineteenth century, but the country was now an "empire of consumption" that relied on foreigners to finance its chronic current account deficits from 1980 onward.[63] The United States received the lion's share of foreign investment, crowding out other possible destinations. The global South and the Eastern bloc in particular suffered from the U.S. dominance in attracting capital, beginning a series of defaults in the developing and socialist worlds beginning with Mexico in 1982. At the Ottawa Summit in the summer of 1981, Mitterrand complained that the high interest rates in the United States attracted the vast majority of investments, leaving little for the French and others.[64] Schmidt disparaged "the highest interest rates since the birth of Christ."[65] U.S. growth reached over seven percent in 1984, consumption boomed, unemployment figures decreased, and inflation held steady under four percent. Financed by foreigners, the United States had finally left

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[61] Quoted in Greider, *Secrets of the Temple*, pp. 561-62.
[62] Krippner, *Capitalizing on Crisis*, p. 189.
[63] Charles S. Maier, *Among Empires: American Ascendancy and Its Predecessors* (Cambridge, MA: Harvard University Press, 2006), p. 255.
[64] Reagan, *An American Life*, p. 350.
[65] Quoted in James, *International Monetary Cooperation Since Bretton Woods*, p. 422.

behind the travails of stagflation–Washington, by luck and skill, solved the puzzle at significant social cost and long-term loss of economic autonomy.[66]

Because of the centrality of the U.S. dollar in international commerce and size of the American economy, the recovery in the United States played the most important role in lifting global capitalism out of recession. No other country could exploit its currency as did the United States, and no other economy was nearly as large. Washington's promotion of the market imposed itself on the rest of the world. As Giovanni Arrighi contends, "Whatever alternative to cutthroat competition for increasingly mobile capital might have existed before 1980, it became moot once the world's largest and wealthiest economy led the world down the road of ever more extravagant concessions to capital."[67] The growing strength of the dollar and the rise of consumption in the United States created export opportunities for the Europeans and aided the recovery across the Atlantic. In addition, the recession and interest rates in the United States encouraged similar develops in Western Europe, and a pattern of austerity unfolded in the other industrial democracies.[68]

In Britain, the increase of interest rates actually preceded Volcker's action, as Chancellor of the Exchequer Geoffrey Howe raised interest rates from 2 to 14 percent as well as budget cuts of £1.4 billion. New Prime Minister Margaret Thatcher supported the policies of austerity by using the slogan: "There is No Alternative." She believed that the government needed to control the money supply to bring down inflation and compel industries to operate with fewer workers and become more efficient. Like Reagan, she wanted to lower income tax and cut public

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[66] My thinking on this issue has been shaped by Fritz Bartel, "Inverting Foreign Aid: The Reagan Financial Buildup," presented at the Clements Center for National Security at the University of Texas at Austin, January 2017.
[67] Giovanni Arrighi, "The World Economy and the Cold War," in *The Cambridge History of the Cold War, Volume III: Endings*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), p. 32.
[68] On the transnational impact of Reaganomics, see Duccio Basosi, "The European Community and International Reaganomics, 1981-1985," in *European Integration and the Atlantic Community in the 1980s*, ed. by Kiran Klaus Patel and Kenneth Weisbrode (New York: Cambridge University Press, 2013), pp. 133-53.

expenditure to encourage wealth-creation in the private sector and decrease the government's footprint in the economy. Thatcher's platform did not pay dividends immediately, and inflation and unemployment climbed. She had an unwavering confidence in the program, however, and famously announced at a Conservative Party Conference in October 1980, "To those waiting with bated breath for that favorite media catchphrase, the U-turn, I have only one thing to say. You turn if you want to. The lady's not for turning."[69]

Thatcher's program, like in the United States, began to tackle inflation and by the mid 1980s the problem had been contained. The question in Britain turned from how to begin the recovery to how to manage the recovery. Treasury official Kenneth Couzens wrote, "The transition was with us: inflation rates worldwide were dropping fast, and interest rates with them."[70] Like their American cousins, the British found the answer in deregulation. London was the second major financial center of the world, but its domestic and offshore financial markets were separate. Seeking to follow the U.S. neoliberal movement, Thatcher integrated the two, opening the London offshore market available to the country. The government abolished the forty-year-old system of exchange controls in October 1979. An additional measure in October 1986 (known as the "big bang") to establish the London Stock Exchange made the London market more attractive to foreigners.[71]

Austerity unfolded elsewhere on the Continent. Even West Germany succumbed to deficits. A *Euromoney* article noted that in the early 1980s, West Germany was "in many ways now finding itself in the same position as was the U.S. in 1977-78, when the Carter

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[69] William I. Hitchock, *The Struggle for Europe: The Turbulent History of a Divided Continent, 1945 to the President* (New York: Anchor Books, 2003), pp. 319-20.

[70] "Record of a Discussion Between the Chancellor and the Foreign Secretary at No. 11 Downing Street at 9.00 a.m. on Monday, 6 December 1982," UKNA, FCO 59/1922.

[71] Helleiner, *The Reemergence of Global Finance*, pp. 149-51. On the challenges facing Thatcher, see Richard Vinen, *Thatcher's Britain: The Politics and Social Upheaval of the Thatcher Era* (London: Simon & Schuster, 2009).

Administration persisted in taking what were seen as half-measures to defend the dollar." In January 1980, Pöhl estimated that the West German current account deficit would reach DM 15-18 billion by the end of 1981. It hit nearly double that amount.[72] Schmidt was replaced by Christian Democrat Helmut Kohl in late 1982, who quickly deregulated transnational financial controls and advocated for big business.

Perhaps the most striking example of the neoliberal ascension in international affairs came in France. The socialist François Mitterrand came to power in May 1981 on a platform of expansionary Keynesian economics. He wanted to protect the country from the deflationary trend of the early 1980s, and make the fight against unemployment his priority. At a televised debate in May 1981, Giscard warned Mitterrand about the dangers of such a program. "The French economy will not stand a boosting of expenditure and further burdens on the employers…Very quickly we would have a massive surge in imports drawn in by the increased demand, and our deficit would widen." The French state borrowing requirement jumped from Ffr 30 billion in 1980 to Ffr 125 billion in 1982. Employers shouldered the burden as minimum wage went up ten percent, and the state introduced the 39-hour work week and fifth week of paid holidays.[73]

The interdependence of France with the rest of the industrial world, however, made such a program unsustainable. Wary of Mitterrand's plans, speculators fled the franc and the value of the French currency dropped precipitously. Mitterrand's program produced climbing current account deficits as well as a rate of inflation that dwarfed those elsewhere in Europe, raising the specter of devaluation. As a member of the EMS, France could not devalue without first demonstrating to its European allies that it was taking austerity measures to diminish the deficits.

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[72] Sarah Martin, "How Germany's Cash Mountain Crumbled," *Euromoney*, March 1981, 34.
[73] "Mitterrand's Place in Economic History," *Euromoney*, July 1982, 9.

Mitterrand ultimately agreed to a plan that committed France to a plan of austerity in return for a ten percent devaluation of the franc within the EMS. This move did little to settle the markets. In 1983 and 1984, Mitterrand yielded to the foreign pressure to reign in his domestic program and embarked an "economic U-turn" that froze prices and wages and cut public spending. The socialist Minister of the Economy and Finance Pierre Bérégovoy inaugurated a program to liberalize and deregulate French financial markets to bring them more in line with their peers in the United States and Western Europe.[74] While the neoliberal ascension in the United States and Britain was driven by conservatives, in France market conditions forced a socialist to embrace austerity and liberalization. As the historian John W. Young describes, Mitterrand's "failed experiment sounded the death knell of old-style state intervention as a cure-all for the woes of free-market economies and confirmed that the future lay with rolling back state expenditures, limiting taxation, and encouraging private enterprise…even if the short-term cost was higher unemployment."[75]

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At long last, the era of stagflation had ended. The reluctant embrace of austerity in the industrial democracies by the late 1970s and early 1980s compelled the economy to correct itself, and the industrial democracies enjoyed steady growth with low levels of inflation. The turn to austerity was a reaction to the challenges of economic globalization, and an acknowledgement of the ability of foreigners to impose domestic policy decisions. This reality came clearly into focus throughout this period, notably in Carter's November 1978 dollar-rescue package and Mitterrand's "U-turn" in 1983 and 1984. Having taken its medicine, the West–particularly the

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[74] Helleiner, *The Reemergence of Global Finance*, p. 140-45.

[75] John W. Young, "Western Europe and the End of the Cold War, 1979-1989," in *The Cambridge History of the Cold War, Volume III: Endings*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), p. 300.

United States–attracted capital from abroad that accelerated growth while allowing Washington to avoid having to make serious decisions about reducing its budget deficits. The oil crisis, which erupted in 1973 and 1979, was a primary source of inflation, but the development of non-OPEC sources of oil and OPEC's decision to raise prices too quickly in a recession lessened the Middle East's hold on the West. Through a combination of difficult policy decisions at home concurrent with changes in the international oil market, capitalism rebounded in the 1980s.

Chapter 8

“We Are Dependent on the West”: The Terminal Decline of Socialism

During a May 1979 meeting in the Politburo, East German policymakers recognized that the *Volkswirtschaft* was in trouble. It was only the middle of May and already they could see that the East German economy would not achieve its goals outlined in the 1979 plan. “We have to think seriously about how to get out of this situation,” General Secretary Erich Honecker told his colleagues, “because the 2.8 percent growth in industrial production achieved so far is not the 5.5 percent that we need.” The performance of the chemical industry, in particular, lagged far behind targets. Some of this could be attributed to decreases in raw material deliveries from the Soviet Union, particularly oil. “Industry is like a delicate clock, and if there is a disturbance, it is difficult to fix,” Honecker worried.[1] He had no answers for how to solve this gargantuan task, no words of wisdom other than an emotional plea that they solve the problems somehow. Honecker understood that continuing down this path posed an existential threat. The prospects for socialism’s success turned in large part on its ability to provide for the material well-being of its citizens. Otherwise, what would be the justification for a socialist East Germany with a more prosperous capitalist West Germany next door? “What the FRG accomplishes, so must we,” Honecker sighed.[2] The problem was that there was a growing and visible gap between what socialism promised and what it delivered. “We announce our successes on television, but it looks different in reality,” he conceded.[3]

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[1] Heinz Klopfer, “Persönliche Niederschrift über die Beratung im Politbüro am 15.5.1979,” May 15, 1979, Bundesarchiv Berlin-Lichterfelde (BAB), Berlin, Germany, DE 1/58659.
[2] “Beratung beim Generalsekretär des Zentralkomitees der SED, Genossen Erich Honecker, zur weiteren Durchführung des Planes 1977 und zur Ausarbeitung des Volkswirtschaftsplanes 1978 am 2. Juni 1977,” June 2, 1977, BAB, DE 1/58746, Bd. 1.
[3] Klopfer, “Persönliche Niederschrift über die Beratung im Politbüro am 15.5.1979.”

The East German situation reflected a broader sickness that infected all of Eastern Europe. The inability of Eastern European exports to earn hard currency drowned the socialists in debt, and their dependence on the capitalists for loans meant that they were no longer sovereign. When the Eastern Europeans decided to engage the industrial democracies in the late 1960s, they had expected it to be temporary. They wanted to combine superior socialist labor organization and central planning techniques with Western technology and Soviet raw materials to develop robust export industries of their own, which they would then use to pay back their debts to capitalist banks. The plan failed. Fueled by Western finance, the Eastern Europeans enjoyed high growth and consumption rates in the first half of the 1970s, but the bill came due at the end of the 1970s. The industrial democracies reluctantly accepted the need to undergo an adjustment period to correct their own problems, but the socialists feared that their regimes could not survive the hardships of austerity. Instead, the Eastern Europeans continued to turn to Western financial institutions as a stopgap measure to meet their economic and social goals. Eastern Europe had entered a state of dependence on the West. This was not a sustainable economic system. As the Polish crisis raged in the summer of 1981, *Euromoney* suggested that "economic ills may yet rot the guts out of the East European economy in a way that no political subversion could."[4]

This chapter contends that by the early 1980s, the socialist bloc had entered terminal decline. The levels of debt and lack of exportable goods meant that socialism–as conceived by the Soviet-bloc states–could no longer be reformed. This chapter unfolds in four parts. First, it examines why the Soviet Union abdicated its role as the lender of last resort for CMEA in the late 1970s. Eastern Europe relied on imports of Soviet raw materials, particularly oil and natural

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[4] "The Next Poland?," *Euromoney*, August 1981, 7.

gas, to power their faltering export industries, but those deliveries began to decrease as Soviet production plateaued in the late 1970s. As the pressure on the Soviet domestic economy increased, Moscow also viewed its informal empire in Eastern Europe as a drain on its resources. In particular, the crisis in Soviet agricultural diverted attention away from the Eastern Europe. Soviet energy exports to the West took on added significance because Moscow needed to compensate for a string of bad harvests. To compensate for failures in the agricultural sphere, Moscow became overly reliant on earnings from energy exports to the capitalist world.

Second, it explores why the socialist bloc was effectively pushed out of the global capital markets in the late 1970s and early 1980s. The increase of interest rates, China's reentry into global capitalism, and growing uncertainty about Eastern Europe's solvency oriented Western banks away from Eastern Europe. While the Eastern Europeans enjoyed access to cheap credit in the early and mid 1970s, the terms hardened sharply at the end of the decade. Capital flows across the Iron Curtain played a paradoxical role in the end of the Cold War. On one hand, access to Western finance allowed the socialists to compensate for shortcomings in their own economies, serving as a temporary fix that compensated for the Eastern bloc's inability to switch from extensive to intensive growth. On the other hand, the accumulation of debt in the 1970s placed the Eastern Europeans increasingly at the mercy of Western financial institutions and dependent on liquidity from abroad. When this capital dried up, the socialists had no answers.

Third, this chapter shows that the decreased flow of Soviet and Western goods and capital created an explosive situation in Eastern Europe, with especially portentous implications in Poland. If the price corrections of 1975 indicated that Moscow would no longer tolerate subsidizing socialism in Eastern Europe, then the Polish crisis of 1980-1981 marked a test case that would indicate just how much the Soviets would sacrifice to protect a sinking component of its informal empire. Poland's declaration of martial law in December 1981 allowed Moscow to avoid the choice between protecting socialism in its informal empire and pursuing its own national interest, but Politburo transcripts demonstrate the Soviets would have chosen the latter.

Finally, it examines the effects of the Western credit boycott against the socialists in the aftermath of the Polish crisis. The Polish crisis scared Western banks, and they rushed to reduce their exposure to losses in Eastern Europe. As the Eastern Europeans defaulted on their debts, Western governments purchased the loans. Western governments were less vulnerable to Eastern European defaults than commercial banks, and could use loans as leverage to compel political changes. A final Eastern European "export offensive" to lower debts failed to make a difference in Eastern Europe's balance sheet, though it did serve to deplete their reserves. The Hungarians joined the International Monetary Fund in 1982, opening access to Western capital once again. The chapter concludes with the extension of the first of two West German *Milliardenkredite* in June 1983. This symbolized the exhaustion of East Germany, which could only stave off economic collapse through the goodwill of its stronger capitalist neighbor. By 1983, this chapter shows, the fate of the Eastern Europeans had been sealed. The relationship between structural economic reform at home and the ability to draw on Western finance had been set.

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The East Germans understood very well the enormous challenge that confronted them in the late 1970s. The chairman of the Council of Ministers Willi Stoph described, "Under new external economic conditions, the main tasks of the economic social policies [of the Ninth Party Congress] must be carried out….[T]he State Planning Commission and the ministers must devise a conception that makes it possible to solve the problems in the balance of payments and increase [economic] performance while not reducing the national economic performance through restrictive plan corrections."[5] The East Germans, however, could not find enough buyers for their exports . "The truth is that we have not mastered the problem of production in the face of the price problem on the world market….The fact that we consume more than we produce doesn't work," Honecker told his colleagues. The deficit of the five year plan had already reached a level of VM 8-10 billion, and "that is outrageous." Consumption levels stayed consistent with those envisioned in the five-year plan, but exports fell drastically short of their targets. Honecker's advisers agreed that even in this situation, East Berlin needed to insulate the people from the deficits. Gerhard Grüneberg insisted that they "should make no moves that interfere with the level of consumption of the people." Werner Jarowinsky added, "Consumption regulation measures can be very dangerous." Price experiments in Poland in 1970 and 1976, and in East Germany in 1977 showed the danger of that. But how, exactly, East Germany would manage to keep its economy running without lowering consumption was the "decisive question."

The East Germans had nowhere else to turn but Western banks. This policy won the day, but the voices against it became louder. Werner Polze, the president of the Außenhandelsbank, spoke out "sharply" against taking out more loans because "raising funds will become more difficult." When the industrial democracies recover, Polze warned, "the capitalists will extend loans to their own first."[6] Polze's fears could be applied to the other Eastern European countries. In his criticism of the Poles in April 1981, Brezhnev chastised Warsaw for modernizing industry only with the aid of Western loans.

> What sense is there if the new factories are fully dependent on raw products, materials and assembled products which must then be obtained with hard currency?...And when it was necessary to repay the loans, they found no way other than to place this burden primarily on the working class. Living conditions for workers have worsened in recent years….When Polish representatives explain why it is difficult for them to take the offensive against counter-revolution, they openly

[5] Günter Mittag to Erich Honecker, May 20, 1977, BAB, DE 1/58746.
[6] "Zur Beratung am 26.5.1978," undated, BAB, DE 1/58620.

> say–we are dependent on the West. That is the greatest lesson for the socialist countries. All of them ought once again to assess the extent of their indebtedness abroad and do everything to prevent it from increasing and approaching a dangerous limit.[7]

Neither the Poles nor the East Germans wanted to continue this dependence on the capitalists, but nobody had a solution that did not involve austerity.

The East Germans flirted with ideas about reducing imports at the margins, but ultimately their solutions involved making unrealistically optimistic plans to increase exports. In his memoirs, SED economics secretary Günter Mittag admitted, "ideological positions and illusions made it incredibly difficult to develop an economic plan that was based in reality. Already in the 1970s, existing realities, which mainly concerned the GDR's external environment, were simply ignored or suppressed."[8] The State Planning Commission, for example, intended in March 1978 to increase exports to the non-socialist world from VM 9.8 billion in 1978 (they ultimately even fell short of this target) to VM 21 billion by 1985.[9] Such estimates were counterproductive. "Our plans for exports to the NSW must be credible," Honecker said. "We have emphasized that in the Politburo, otherwise there is a danger of the people becoming demobilized. What does it mean for a business to target an increase [of production] by 30 percent without having the means to do so? We make it impossible."[10] Mittag acknowledged that East Berlin could not complete a third of its economic goals, and when he took changes in prices on the world market into account, that figure climbed to fifty percent.[11]

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[7] "Document No. 42: Brezhnev's Speech to the CPCz CC Politburo," April 7, 1981, in *From Solidarity to Martial Law: The Polish Crisis of 1980-1981, A Documentary History*, ed. by Andrzej Paczkowski and Malcolm Byrne (Budapest and New York: Central European University Press, 2007), 257-58.
[8] Günter Mittag, *Um jeden Preis: Im Spannungsfeld zweier Systeme* (Berlin und Weimar: Aufbau Verlag, 1991), 79.
[9] Staatliche Plankommission, "Grundfragen der Zahlungsbilanz 1979-1985," March 16, 1978, BAB, DE 1/58620.
[10] "Ausführungen des Genossen Erich Honecker auf der Beratung des Politbüros am 15.8.1978 zur Planerfüllung," undated, BAB, DE 1/58647.
[11] Heinz Klopfer, "Persönliche Niederschrift über einen Beratung beim Mitglied des Politbüros und Sekretär des ZK der SED, Genossen Dr. Mittag, am 18.4.1979," April 18, 1979, BAB, DE 1/58657.

Any hope that the Eastern Europeans could catch up and rectify their deficits depended on the continued willingness of the Soviet Union to provide raw materials at cheaper prices than on the world market. They wanted to receive Soviet materials, but export to the non-socialist world to earn hard currency to pay back debts. Economic growth in East Germany, an official in the trade ministry told the Soviets, depended on the "timely delivery of Soviet raw materials."[12] The Soviet Union did not like this arrangement, and Soviet policymakers resisted Eastern European overtures for more aid. They resented the Soviet role as a provider for Eastern Europe, and they believed that Eastern Europe constituted a drain on their resources. Moscow assumed, correctly, that Eastern Europe preferred to export to the industrial democracies, and limit the quantity of goods bound for the Soviet Union. At a March 1979 meeting with Schürer, Tikhonov asked to meet privately with the East German, without translators. Tikhonov asked whether there was a tendency among East German officials toward weakening cooperation with the Soviet Union in favor of creating stronger bonds with the capitalist industrial states. The Soviet share of East German trade had declined three percent between 1970 and 1978. Tikhonov indicated that Moscow worried about East German reluctance to sign trade agreements, and he was concerned that several ministers and organizations in the GDR would rather collaborate with Western companies than the Soviets.[13]

Soviet economic woes inhibited their ability to protect Eastern Europe. The CIA predicted that "Moscow will try to walk a tightrope between the increased needs of Eastern Europe and the needs of its own economy…..Over the longer term…we believe this strategy is

[12] "Zapis' besed Zamestitelya Ministra t. Osipova N.G. S Torgovym predstavitelem GDR v SSSR t. K. Enkel'mannom, sostoyavsheysya 21 iyunya 1978," RGAE, f. 413, op. 31, d. 9427.
[13] Gerhard Schürer, "Information über ein Gespräch zwischen Genossen Tichonow und Genossen Schürer," March 21, 1979, BAB, DE 1/58658.

untenable. Soviet economic problems are too severe."[14] The Soviet energy industry had always drove economic growth within CMEA, but Soviet policymakers wanted to divert more energy to the West to compensate for a growing crisis in agriculture. Recognizing the high stakes, Moscow knew that it had to pour more resources into agriculture. The Soviets increased investment in the agricultural sector, which accounted for more than a quarter of the state budget. It now occupied a top position in the list of Soviet priorities. Baibakov told Schürer in September 1981, "The USSR must develop its economy differently in the future and the agricultural economy, which currently receives 27 percent of investment, must receive more attention."[15]

Shortages of foodstuffs increased. Chernyaev recorded complaints received from around the Soviet Union, collected for the Politburo. "Butter's not for sale anywhere, milk only occasionally, and the supply of meat and vegetables is irregular," read one from Yaroslavl. "All there is in stores is bread, salt, margarine, and jars of compote," another one stated from Uglich. "We don't know what to feed the children. Milk is available only by coupons, and only for kids younger than three." In contrast to life in the Kremlin, where the elderly leadership enjoyed pinning medals and awards on each other, Chernyaev noted, "people all over the country had a very hard life."[16] The political scientist Philip Hanson writes, "The Soviet leadership was preoccupied with the farm sector. They might order the invasion of Afghanistan…and extend military assistance to Angola, but they showed every sign of worrying much more about meat and milk supplies." At the Party Central Committee plenum in November 1981, Brezhnev

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[14] National Foreign Assessment Center, "USSR: Economic Issues Facing the Leadership," January 1981, CREST.
[15] Gerhard Schürer, "Information über das Gespräch mit Genossen Baibakow," September 16, 1981, BAB, DE 1/58682.
[16] William Taubman, *Gorbachev: His Life and Times* (New York: Norton, 2017), 168-69.

identified the food problem as the most important challenge in the current five-year plan, "on the political plane as well as on the economic plane."[17]

Just as they had under Nikita Khrushchev, the Soviets embarked on an ambitious program to utilize a greater portion of Soviet territory for farming. In 1976, the Soviets launched a 15-year project to develop the agricultural base of the Russian Nonchernozem Zone (RNCZ)–a region that represented 13 percent of the territory (280 million hectares–roughly the size of Western Europe) and 23 percent of the total population of the Soviet Union. Nonchernozem referred to infertile soils with low potential for agricultural production, which ranged from the lands east of the Ukraine, Belorussia, and Baltic republics. The RNCZ covered a large portion of this territory. The RNCZ originated with the idea that each province should become self-sufficient in food to the extent possible, and Soviet policymakers wanted to develop more territory that would boost total output. The largest agricultural program since Khrushchev's New Lands project in the 1950s, the RNCZ sought to double agricultural production by 1990. The Soviets poured a fifth of their agricultural budget into the RNCZ, increased the use of fertilizers, and constructed largescale and highly mechanized agricultural enterprises. Writing in February 1983, the CIA concluded: "So far the program has been a failure on almost every score." Total agricultural production actually *declined* since 1977, at a rate faster than Soviet agriculture overall. Important factors for its failure included harsh climate, low quality of soil, shortages of skilled labor, and deficiencies in Soviet agrotechnology.[18]

Harsh climates that made consistent harvests difficult, but fluctuations could not just be ascribed to climate. Canadian farmers, for example, had to contend with similar weather

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[17] Philip Hanson, *The Rise and Fall of the Soviet Economy: An Economic History of the USSR from 1945* (New York: Longman, 2003), 149.
[18] CIA paper, "Soviet Agriculture: Reviewing a Core Program," February 1983, CREST, https://www.cia.gov/library/readingroom/docs/DOC_0000498505.pdf.

conditions, and their harvests were much more consistent.[19] The Soviet system and the legacies of collectivization meant waste, inefficiency, and bottlenecks. Change was not so easy. In early 1982, Mikhail Gorbachev, then the Central Committee's secretary for agriculture, held a meeting of academic experts on Brezhnev's Food Program. Put at ease by Gorbachev's personality, the experts told him that the program consisted of "half-measures that would change nothing." Instead, they advised replacing the existing agro-industrial ministries in favor of one single agency. Gorbachev turned to his assistant and asked, "If I were to include that suggestion in my proposal, do you think I'd still be allowed to sit in this chair?"[20]

Because the Soviets needed to consume an increasing share of their agricultural production, there was less that they could export to Eastern Europe. East German State Planning Commission statistics from 1984 indicate that in 1970, East Berlin imported a total of 3.2 million tons of grain. Of this amount, 1.7 million tons came from the Soviet Union. This level of import, however, dropped rapidly after 1974. Thereafter, grain imports did not rise again above 840 thousand tons, and East Berlin received no grain from the Moscow in 1978, 1980, 1981 (15 tons), 1982, and 1983.[21] Even between 1975 and 1977–when East Germany still received grain from the Soviet Union–it had to spend $720 million on grain imports from the capitalist world.[22] Since East Germany's founding, a government report noted, the Soviet Union delivered grain in meaningful quantities. While during the years 1971-1975 the Soviet Union exported 6.2 million tons, during 1976-1980 that figure fell to 1.5 million tons. This raised a significant problem. In East Berlin's five-year plan, policymakers counted on receiving more than 8 million tons of

[19] Hanson, *The Rise and Fall of the Soviet Economy*, 153.
[20] Taubman, *Gorbachev*, 186.
[21] Staatliche Plankommission, "Getreideimporte der DDR in den Jahren 1970 bis 1984," undated, BAB, DE 1/58747.
[22] "Import von Getreide aus der UdSSR für das Jahr 1978," undated (handwritten note at the top of the folder that reads: "for Stoph's trip March 1978"), BAB, DE 1/58564.

grain from the Soviet Union. As a result, the East Germans had to turn to the capitalist market to meet their needs.[23]

Long-term solutions required structural changes. In the short-term, the only way to meet domestic consumption levels was to purchase grain on the world market, particularly from the United States. While the Soviet Union purchased 2.2 million tons of grain on the world market in 1970, it had to buy 29.4 million tons in 1982 and an astounding 46 million tons in 1984. The transition was complete; imperial Russia may have been the world's largest exporter of grain in the early twentieth century, but by the 1980s, the Soviet Union was the world's largest importer.[24]

Soviet agriculture became a matter of world politics after the Red Army's invasion of Afghanistan in December 1979. As part of a package of retaliatory measures, the Carter administration announced a grain embargo against the Soviet Union on January 4, 1980. "Unless the Soviets recognize that [the invasion] has been counterproductive for them," Carter wrote in his diary, "we will face additional invasions or subversion in the future."[25] Soviet ships could not fish in American waters, and the export of high-tech and agricultural equipment was sharply cut. Despite lukewarm responses from American allies in Western Europe, the embargo hit Moscow hard. Just the year before, the Soviet Union imported 25.9 million tons of grain from the United States. The next year, it dropped to 8.5 million tons. Imports from Canada and Argentina increased slightly, but the Soviets received 11 million tons less in 1980 than they had in 1979.[26]

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[23] "Entwicklung der Getreideimport der DDR aus dem sozialistischen Wirtschaftsgebiet und dem NSW," undated (likely 1985), BAB, DE 1/58757.
[24] Yegor Gaider, *Collapse of an Empire: Lessons for Modern Russia*, tr. By Antonia W. Bouis (Washington, DC: Brookings, 2007), 95
[25] Jimmy Carter, *White House Diary* (New York: Farrar, Straus, and Giroux, 2010), 387-88.
[26] Figures cited in Werner Lippert, *The Economic Diplomacy of Ostpolitik: Origins of NATO's Energy Dilemma* (New York: Berghahn, 2011), 163.

In sum, the Soviets lost about 17 million tons.[27] It was not a good time for Moscow to face more agricultural problems.

The grain embargo hurt the Soviets, but many in the Carter administration (and certainly in Western Europe) wondered whether it was prudent. In particular, U.S. officials worried that the embargo hurt American farmers. Representatives of Continental Grain, for example, told U.S. officials in April 1980 that the embargo was "an exercise in futility" and that the American farmers bore "a disproportionate amount of the burden."[28] On the campaign trail and when Ronald Reagan entered office, he too worried about the embargo's impact at home. "We shouldn't lift it unless the Russians show some signs of being decent," he wrote in his diary in March 1981. "Still it's hurting our farmers I fear worse than it's hurting the Russians."[29] Bending to domestic pressure, Reagan lifted the embargo in April 1981.

The crisis in agricultural had significant implications for the energy industry. In order to compensate for agricultural shortages, Moscow depended increasingly on the energy trade to compensate. "The grain imports of the USSR are based on the export of oil and petroleum products," Baibakov said. He later remembered that the Soviets received $15 billion for oil and natural gas exports in 1976-80 and $35 billion from 1981-85. Of this income, the Soviets used $14 billion and $26.3 billion, respectively, to purchase grain from the industrial democracies to feed cattle and Soviet citizens.[30] The Soviets did not have a range of products that would be competitive on the world market. The director of a Soviet think tank Gregorii Arbatov wrote in his memoirs, "Of course, it's better to export VCRs, airliners, and if worse comes to worst, cars,

[27] Mikhail Gorbachev, *Memoirs* (New York: Bantam Books, 1997), 148.
[28] Barbara Bergman to Lloyd Cutler, "April 23 Meeting with Continental Grain Officials," April 23, 1980, JCPL, White House Office of Counsel to the President, Patrick Apodaca's Subject Files, Grain Embargo, Box 185.
[29] *The Reagan Diaries*, ed. by Douglas Brinkley (New York: HarperCollins, 2007), 10.
[30] Vladislav Zubok, "Soviet Foreign Policy From Détente to Gorbachev, 1975-1985," in *The Cambridge History of the Cold War: Volume III, Endings*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), 95.

lathes, and instruments, rather than oil. But if you don't have competitive, high-tech goods or even industrial end products, then there's no alternative."[31] By 1980, energy constituted 67 percent of Soviet exports to OECD countries.[32] The stakes for ensuring the smooth functioning of the Soviet energy industry were thus very high.

With the enormous oil and natural gas reserves in western Siberia, the Soviet Union had become a world leader in energy production by the 1970s. Energy production and consumption climbed quickly. As early as the early 1970s, the Soviets understood that they faced a looming energy crisis. "We stand at the threshold of stagnation in the production of oil, a bit later perhaps even a reduction," Gosplan official Nikolai N. Vorov told East German policymakers in August 1977. The Soviets expected a growth in the production of oil from 500 million tons to 640 million tons during the five-year-plan of 1976-1980, but a third of the 140 million ton increase assumed production in the Barents Sea oil fields that had still not been developed at that point. Soviet geologists had begun to explore the region, but the fact that the Barents Sea was only free of ice for three months each year hindered production. The situation would worsen the following decade; overall growth from 1980-1990 would quickly decelerate, and Vorov anticipated an increase of only 20 or 40 million tons ("practically no growth").[33]

Vorov depicted a better picture of the natural gas situation, but he tempered expectations. An increase in exports there was "theoretically possible," he said, but there remained the great cost of transporting energy from Tyumen to the western border of the Soviet Union–a journey

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[31] Georgii Arbatov, *The System: An Insider's Life in Soviet Politics* (New York: Random House, 1992), 216.
[32] Yegor Gaidar, *Collapse of an Empire: Lessons for Modern Russia*, trans. by Antonina W. Bouis (Washington, D.C.: Brookings Institution Press, 2007), 103.
[33] Karl Grünheid, "Notizen über Ausführungen des Genossen Worow, Abteilungsleiter im Gosplan der UdSSR, zu Fragen der Entwicklung der Produktion und Lieferungen der UdSSR an Erdöl und Erdgas," August 1, 1977, Stiftung Archiv der Parteien und Massenorganisationen der DDR im Bundesarchiv (SAMPO), Berlin, Germany, DY 3023/1529.

that totaled 7,000 km. "Nobody has a solution," Vorov admitted.[34] Gosplan officials noted that the deposits were located in remote and "eternally frozen tundra."[35]

Continued relations with the Western Europeans offered solutions for the production of natural gas. In early 1978, Moscow began signaling to Western European firms that it sought to negotiate a new wave of energy agreements. The enormous (and isolated) untapped fields on the Yamal peninsula in Siberia enticed Western European policymakers and businessmen. Soviet officials sought to copy the success of the Soyuz pipeline that transported natural gas from the Orenburg reserves direct to consumers in Eastern Europe. This time, the pipeline would ship natural gas only to Western Europe. An advantage to this project for the Western Europeans was that it separated Soviet exports from the domestic pipelines, eliminating the threat that the Soviets would divert energy meant originally for foreigners to the domestic market in times of crisis.[36] The West Germans pitched a new project to the Soviets in which a multinational consortium of Western European companies would construct a pipeline that would transport 20 billion cubic meters of natural gas per year, likely requiring a loan of DM 12-13 billion.[37]

At the same time, Western Europeans and Soviets also continued to engage Iran about natural gas imports. Negotiations between Western European firms and Iran involved the Soviet Union because some believed that the most efficient way to ship Iranian gas all the way to Western Europe was through an exchange system with the Soviet Union. Ruhrgas proposed that Iranian gas be pumped through existing Soviet pipelines, or that the three sides negotiate a

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[34] Ibid.
[35] Karl Grünheid, "Information über die 1. Konsultation mit dem Staatlichen Plankomitee der UdSSR zu Frage der Energie- und Brennstoffversorgung im Zeitraum nach 1980," undated (report of meeting that took place on July 28-29, 1987 in Moscow), SAMPO, DY 3023/1529.
[36] Per Högselius, *Russia and the Origins of European Energy Dependence* (New York: Palgrave MacMillan, 2013), 179-80.
[37] V.N. Mashura, "Memorandum," February 8, 1978, RGAE, f. 413, op. 31, d. 9428.

"switch" in which the Soviets would import gas from Iran, then ship the same amount to Western Europe.[38]

The Iranian Revolution, however, disrupted the plans. The Iranians suspended work on their pipelines, the Soviet Ministry of Gas Director Nikolai Osipov reported, and at the moment "it is still difficult to expect a final decision on their transaction from the current unstable [Iranian] government."[39] "In the behavior and statements of the Iranian representatives, interest in the implementation of projects for the export of Iranian gas to Western European countries and the desire to reach an agreement on all issues of interest to them was clearly lost."[40]

Preparations to construct the Yamal pipeline, however, pushed forward. In a global age of scrambling for energy, the Soviet reserves offered the Western Europeans an opportunity to diversify their suppliers. Pointing the increasing demand for natural gas in Western Europe and dwindling reserves in the Netherlands, Osipov noted that Soviet contracts to Western Europe after 1980 totaled about 30 billion cubic meters per year.[41] Bonn also believed that cooperating with Moscow ensured that the Soviets would not become stronger competitors for energy imports from the Middle East.[42] Rather than purchase energy on the world market, the Soviets would have their own. The West German energy firm Ruhrgas took a leading position in the negotiations, representing other firms from West Germany such as Thyssengas and Salzgitterferngas. After agreements with the Soviets in 1970, 1972, and 1974, the West Germans received 12 billion cubic meters per year from Soyuzexport to supply principally areas in

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[38] Högselius, *Red Gas*, 172-73.
[39] "Memorandum," July 9, 1979, RGAE, f. 413, op. 32, d. 45.
[40] "Zapis' besedy Zamestitelya Sovetnika po ekonomicheskim voprosam Posol'stva SSSR v Irane Nartsissova V.S. s torgpredom ChSSR v Irane V. Rudol'fom, sostoyavsheysya 5 marta 1980 goda v sluzhebnom zdanii AES v Tegerane," RGAE, f. 413, op. 32, d. 787.
[41] "Memorandum," July 9, 1979, RGAE, f. 413, op. 32, d. 45.
[42] Referat III C 4/V B 1, "Neues Erdgas-Röhren-Geschäft mit der UdSSR," February 27, 1981, BAK, B 102/271674.

Bavaria and Hessen. By 1979, Soviets had cornered about a fifth of the West German market.[43] The West German government gave permission to the business consortium in May 1980 to proceed with negotiations about the new natural gas agreement, provided that the share of Soviet gas did not exceed 30 percent of total West German consumption.[44] The West Germans sought between 12-15 billion cubic meters annually in the deal; other interested parties included Italy (7-11 billion cubic meters), France (8-10 billion cubic meters), Belgium and the Netherlands (5-6 billion cubic meters each), and Austria (3-5 billion cubic meters), among others.[45] In sum, the Soviets received requests for 60-70 billion cubic meters per year for the Yamal pipeline. Osipov indicated that he adhered to the "old concept" of receiving loans, and then the loans would be paid back in natural gas deliveries.[46]

Previous U.S. administrations had generally approved of Western European engagement with the Soviet energy industry in the 1970s, but Reagan's election in November 1980 signaled a change of direction. Prominent members of the new administration worried that the pipeline deals would strengthen the Soviet Union. They knew that energy represented the only sector of the economy in which the Soviets could earn significant amounts of convertible currency. They also knew, however, that their allies in Western Europe needed more energy and that a restrictive U.S. export policy would be ineffective if it did not have international support. At a National Security Council meeting in July 1981, the Reagan administration considered tightening COCOM export controls. The hardliner Secretary of Defense Caspar Weinberger pushed for

[43] Bundesminister für Wirtschaft, "Aufzeichnung: Voraussichtliche Entwicklung der deutschen Erdgasimporte, insbesondere aus der Sowjetunion," April 24, 1980, BAK, B 102/271674.
[44] Referat III C/III C 4, "Sprechzettel: Gespräch mit dem Bundeskanzler am 23. Februar 1981 über das neue Erdgas-Röhren-Geschäft mit der UdSSR," February 23, 1981, BAK, B 136/270475.
[45] Ruhrgas Aktiengesellschaft, "Memorandum über das neue sowjetische Erdgas-Exportprojekt," August 12, 1980, BAK, B 102/270475.
[46] "Memorandum 13 dekabrya 1978 g. zamestitel' ministra tov. Osipov N.G. Prinyal predsedatelya pravleniya zapadnogermanskogo banka 'Doyche bank A.G.' F.V. Kristiansa po yego pros'bo," January 3, 1980, RGAE, f. 413, op. 32, d. 45.

strict regulation of technology that could be helpful to Moscow. He understood that the Western Europeans needed energy, but he thought that the need to deny the Soviets resources trumped that. “We sent scrap iron to Japan before World War II and we are doing a great deal to increase Soviet capabilities,” Weinberger said. “We need a harder line position….We need to demonstrate to our Allies that it is not in our interest to increase Soviet capabilities.” CIA director William Casey agreed, arguing, “We have the right to tell our Allies they should not put in the pipeline if they expect us to defend them.” Others, particularly in the economics parts in the government, took a different line. Secretary of Commerce Malcolm Baldridge pointed out that even if the Reagan administration prohibited the sale of oil and gas technology, the Soviets could get it elsewhere. “The products—pipelayers, compressors, drill bits—are generally available from other sources,” he said. Secretary of the Treasury Donald Regan supported Baldridge, saying that they should underestimate the impact of potential energy shortages in Western Europe. “It is advisable to keep the gas flowing,” he concluded.[47]

The announcement of martial law in Poland swung the balance in favor of Weinberger and the hardliners. The Reagan administration instituted an export ban on oil and gas technology and equipment. Demonstrating both the growing ability of the Western Europeans to defy Washington when its interests were at stake and the durability of détente in Europe, however, the Western Europeans nevertheless pushed ahead on the Yamal pipeline. British Prime Minister Margaret Thatcher complained that the export restrictions hurt British companies during a recession. “Naturally we feel particularly deeply wounded by a friend,” Thatcher said publicly.[48] The French Foreign Minister Claude Cheysson pointedly asked why the Western Europeans

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[47] “Minutes of a National Security Council Minute,” July 6, 1981, FRUS, 1981-1988, Vol. 3, doc. 68

[48] Hal Brands, *Making the Unipolar Moment: U.S. Foreign Policy and the Rise of the Post-Cold War Order* (Ithaca, NY: Cornell University Press, 2016), 84.

should "punish" themselves with sanctions while the U.S. went ahead with their multimillion ton grain agreement with the Soviet Union. Schmidt added that Washington did not have the right to tell the Europeans how to manage their energy dilemma. The United States "have not given us a single gallon of oil…or of gas. You cannot do it. So we have to diversify." The Western Europeans allowed their companies to undercut U.S. sanctions against Moscow.[49] The West Germans were the first to sign an agreement with the Soviets in November 1981, and the Italians and French the following month. By 1982, West Germany received 30 percent of its natural gas from the Soviet Union, France 27 percent, and Italy 64 percent.[50] The interdependence of the energy trade brought the Soviets and Western Europeans into a tight embrace.

Agreements with the Western Europeans provided opportunities, and Soviet policymakers increasingly resented their responsibilities to export subsidized energy to Eastern Europe. They saw that continued subsidization had effects on the Soviet domestic economy. In his diary, Chernyaev noted that the Eastern Europeans constantly pressed for more economic integration with the Soviets, seeking more resources to pay back Western loans and imports. They warned that if Moscow did not do so, they could not give up their ties with the West. But the Soviets could simply not accommodate those demands. Chernyaev observed, "We cannot go to an even larger reduction in our standard of living."[51] In trade negotiations, the Soviet resentment came to the surface. At a June 1979 meeting with his East German counterpart Horst Sölle in Moscow, for example, Soviet Foreign Trade Minister Nikolai Patolichev displayed far less sympathy for the East Germans that he had during the price adjustment negotiations in 1974.

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[49] Lippert, *The Economic Diplomacy of Ostpolitik*, 168-69.
[50] Bruce Jentleson, *Pipeline Politics: The Complex Political Economy of East-West Energy Trade* (Ithaca, NY: Cornell University Press, 1986), 201.
[51] Diary entry for February 12, 1980, in Anatolii Chernyaev, *Sovmestyi iskhod: Dnevnik dvykh epoch 1972-1991 gody* (Moscow: Rosspen, 2008), 393.

"One must not only judge this problem from the perspective of the buyer, for whom the price of imports has naturally increased, but also from the perspective of the seller, who receives far less currency for this critical resource than could be obtained on the world market." The Eastern Europeans continued to complain about the price adjustments that the Soviets implemented in the mid 1970s. Patolichev exploded, "That the Soviet Union loses 20 to 30 rubles per ton of oil in comparison to world market prices is not even considered. The Soviet Union can no longer bear such a disadvantage, that is completely out of the question." He estimated that the opportunity cost of providing East Germany with oil at a subsidized price cost Moscow about 1.5 billion rubles from 1975-1980.[52]

In conversations with its allies, the Soviet Union increasingly brought up the topic of financing Eastern European debt to the capitalist world. When the Czechoslovaks announced an increase in prices for certain goods, the Soviets responded favorably. "The leadership of the CSSR cannot afford to take on more debt," a Soviet official approved. "The USSR can no longer intervene–the Soviet people do not understand any more why we are lending to all countries, but the shelves in our own shops are empty."[53]

In the context of consecutive poor harvests and an increasing dependence on the energy sector, the balance of trade between the Soviet Union and the members of CMEA remained sticking points. At a meeting between Soviet and East German policymakers in December 1978 to discuss coordination between the two countries, the central points of contention included Soviet energy and agriculture, and their relationship to the functioning of the East German economy. After giving a survey of the economic troubles facing East Berlin, Stoph told Kosygin,

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[52] "Niederschrift über ein Gespräch mit dem Minister für Außenhandel der UdSSR, Genossen Patolitschew, am 6.6.1979," June 6, 1979, SAMPO, DY 30/IV 2/2.2035/56.

[53] Gerhard Schmitz, "Information zu Meinungen sowjetischer Genossen über die Frage der Verschuldung sozialistischer Länder in konvertierbaren Devisen," March 3, 1982, SAMPO, DY 30/25765.

"Securing raw materials is an existential issue [*Lebensfrage*] for our republic and of fundamental importance for the development of relations between our countries. The reduction of dependence on the capitalists is a strategic necessity….It is in the interest of the GDR, USSR, and the entire socialist community." Stoph believed that increased deliveries of raw materials contained the key to expanding the East German ability to increase its exports to the capitalist world, and finally resolve the import dependence [*Importabhängigkeit*] on the imperialists. He repeatedly referred to it as a *Lebensfrage*.[54]

The Soviets countered these points. Baibakov noted that the Soviets delivered "only" 16 million tons of oil and 5.8 billion cubic meters of natural gas. "The numbers speak for themselves," Baibakov said. "They are pretty big." Kosygin added that the Eastern Europeans wanted more energy, then they needed to take a greater part in the development of the Soviet energy reserves. The Soyuz pipeline was a successful example of socialist cooperation, where the Eastern Europeans participated by supplying machines and equipment. "That is a serious, real form of participation." Such participation was rare. The Soviets wanted Eastern European participation in building a factory, for example, but the Eastern European interest in cooperation essentially amounted to "a purchase and a sale. That is the exact same thing as when we sell something on the capitalist market." Kosygin pointed to rising demand as the chief reason for energy shortages and lectured Stoph:

> I would like to say that the whole economy of the GDR is in a rather privileged position. You will not think about that much, but I would like to remind you….Where do you find, Comrade Stoph, such a place in the world where oil and gas come immediately through pipelines practically to your front door? You don't need transport or tankers….The economy of the GDR is in paradise and in a rather privileged and better position than the economies of Italy, France, and West

[54] Willi Stoph, "Stenografische Niederschrift der Beratung des Vorsitzenden des Ministerrates der DDR, Genossen Willi Stoph, mit dem Vorsitzenden des Ministerrates der UdSSR, Genossen Alexej Kossygin, am Freitag, dem 8. Dezember 1978, in Moskau," December 11, 1978, BAB, DE 1/58667.

> Germany. That is true also in natural gas….You have a very favorable situation, a very favorable situation.

"I must say to you openly," Kosygin continued, "that we are not at the moment in a position to grant any more credits. We have very considerable spending on the military, and besides that we have a lot of spending on agriculture."[55] After more poor harvests in the Soviet Union, Moscow informed East Berlin that it would have to decrease oil deliveries to East Germany. In response, Schürer asked rhetorically whether a strong socialist East Germany still played a role in Soviet plans. "Imperialism stands right at the door of our house with its hate on three television channels," he said. Baibakov snapped back, "Should I cut back on oil to Poland? Vietnam is starving…should we just give away Southeast Asia? Angola, Mozambique, Ethiopia, Yemen…we carry them all. And our standard of living is extraordinarily low."[56]

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As the Soviet economic woes affected Moscow's ability and willingness to provide for CMEA, the West also was less willing to support the struggling Eastern Europeans. Flush with petrodollars, Western banks had poured money into the region during the 1970s. They believed that Eastern European socialist regimes were reliable and stable, and the global recession gave the banks few compelling alternatives in which they could invest their capital. A West German report in the Kanzleramt noted that within banking circles in 1978, East Germany, for example, was still considered as a "good credit risk" despite its growing debt.[57] The Eastern European

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[55] Ibid.
[56] Quoted in Stephen Kotkin, "The Kiss of Debt: The East Bloc Goes Borrowing," in *The Shock of the Global: The 1970s in Perspective*, ed. by Niall Ferguson, Charles S. Maier, Erez Manela, and Daniel J. Sargent (Cambridge, MA: Harvard University Press, 2010), 83.
[57] Referat IV C 1, "Westverschuldung der DDR Ende 1978 im Vergleich zur Westverschuldung der übrigen Staatshandelsländer," August 16, 1979, BAK, B 136/19090.

ability to obtain loans depended on a continued lack of demand in the West, the development of international liquidity, particularly in the Euromarket, and the ability to remain in the good graces of the banks.

They recognized their vulnerability to a sudden change. An East German report in December 1978 warned that maintaining the country's current level of imports "presupposes that the liquidity situation in the capitalist money and credit markets will not change significantly and that the capitalist banks will at least maintain at the current level or increase their credit limits vis-à-vis the Außenhandelsbank or Handelsbank."[58] Continued access to the Western financial markets was a priority of the highest order. "The extent of further credits is a question that can have big political effects because we will come under the pressure of capitalist powers with increasing debts."[59] If the East Germans fell behind in their payments, it would be difficult to catch up. By the end of 1978, the debt to capitalist banks stood at VM 21.3 billion, of which VM 17.8 billion was in convertible currency. 80 percent of East German imports had to be financed with credit. East Berlin's trade structure was unsustainable, and they knew it.[60] Only through Western loans could the East Germans continue to supply their people and avoid austerity measures, which they considered politically suicidal.

Trouble loomed on the horizon. A set of factors coalesced to push the East Germans and their socialist allies effectively out of the capital markets in the late 1970s and early 1980s. First, the increase of interest rates in the United States and elsewhere changed the dynamics of international lending. Demand for credit in the United States began to increase in 1978, leading

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[58] Horst Kaminsky, "Vorlage für die Beratung der Arbeitsgruppe Zahlungsbilanz beim Politbüro des ZK der SED am 11.12.1978," December 6, 1978, BAB, DN 10/3067.
[59] Staatliche Plankommission, Bereich Außenwirtschaft, "Unterschiedliche Standpunkte zu den staatlichen Aufgaben 1979 aus der Planberatung mit dem Minister für Außenhandel," April 3, 1978, BAB, DE 1/58664.
[60] Gerhard Schürer, Siegfried Böhm, Horst Kaminsky, and Werner Polze, "Stand der Zahlungsbilanz der DDR gegenüber dem nichtsozialistischen Wirtschaftsgebiet 1978 und 1979 sowie erforderliche Maßnahmen," February 1, 1979, BAB, DE 1/58746.

U.S. interest rates to rise by about three percent in 1978. East German Außenhandelsbank President Werner Polze reported in May 1978 during a trip to the United States that the rising demand for credit and the climbing interest rates have caused "a greater orientation of U.S. banks to extending credits in the domestic market." He predicted that this trend would continue.[61] Sure enough, the Carter administration's efforts to stabilize the dollar after the crisis of November 1978 posed another threat to East Berlin because it further limited credit opportunities in the U.S. market, and by extension the Euromarket. Because of Carter's actions to support the dollar, Polze believed that "a noticeable shortage of loans on the international money market must be expected."[62] The most dramatic development came after the appointment of Paul Volcker as chairman of the Federal Reserve. In October 1979, Volcker announced a series of measures that would drastically tighten U.S. monetary policy, and interest rates reached nearly 20 percent by the spring.

The so-called Volcker shock reverberated across the world, with global consequences for international finance.[63] As Washington sought to decrease its money supply in its fight against inflation, global liquidity decreased. Polze reported that on the Euromarket, for example, the volume of credit during the first half of 1980 decreased by 15 percent in comparison to the same period the previous year. "The share of socialist countries in Eurocredits fell the most," Polze observed. In the first half of 1980, the socialist countries managed to raise $950 million. "That is less than a fifth of the volume of the first half of 1979." Chairman of Gosbank Vladimir Alkhimov indicated that with the situation on the capitalist market and the position of the United

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[61] Werner Polze, "Bericht über eine Dienstreise nach den USA und Kanada in der Zeit vom 8. bis 19.5.1978," May 23, 1978, BAB, DN 10/447.
[62] Werner Polze, "Bericht über eine Dienstreise des Präsidenten der Deutschen Außenhandelsbank nach Großbritannien in der Zeit vom 25.10.- 2.11.1978," November 3, 1978, BAB, DN 10/447.
[63] On the global implications of the Volcker shock, see Giovanni Arrighi, "The World Economy and the Cold War, 1970-1990," in *The Cambridge History of the Cold War: Volume III, Endings*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), particularly 31-40.

States against the socialist states meant that the CMEA would face tough credit conditions for the foreseeable future.[64] The increase of interest rates to scarcely believable levels served to funneled capital flows away from Eastern Europe. In particular, Kaminsky and Polze observed, they "directed capital flows toward the United States." The demand for U.S. dollars continued to increase in the context of the second oil shock, as countries wanted to acquire more dollars to pay for oil imports.[65]

Interest rates across the industrial democracies remained high during the 1980s. In 1982 and 1983, Polze wrote, "the socialist countries receive fewer loans than they had to pay back. In 1983 there was a further reduction of the volume of international loans." Eastern Europe faced stiff competition for loans. Polze noted that with their 1983 trade deficit of 60 billion francs and current account deficit of 35 billion francs, the French had to take out loans of $12 billion that year alone. The dominant country, however, remained the United States. "The United States will continue its high interest policies in the future without taking into account its allies, because they correspond to the interest of U.S. imperialism." Polze continued: "With the aid of the high interest rate policies and the resulting higher real interest rate of the U.S. dollar against other capitalist currencies, the capital flows are directed toward the United States."[66] "The United States controls 80 percent of the money market," Schürer added in June 1982. "The other

[64] Werner Polze, "Information über die Lage auf den kapitalistischen Geld- und Kreditmärkten," August 13, 1980, BAB, DN 10/616.
[65] Horst Kaminsky and Werner Polze, "Zur gegenwärtigen Lage auf den kapitalistischen Devisenmärkten," April 21, 1980, BAB, DN 10/616.
[66] Werner Polze, "Einschätzung der Lage auf den kapitalistischen Geld- und Kreditmärkten einschließlich der Entwicklung der Zinssätze und Schlußfolgerungen für die Zahlungsbilanz 1984," January 5, 1984, SAMPO, DY 3023/982.

capitalist countries submit to the diktats of the United States."[67] Between 1980 and 1989, $347.4 billion flowed into the United States.[68]

Climbing interest rates also made accepting loans far more expensive. In planning for the year 1980, the GDR Department of Planning and Finance concluded in June 1979 that the current plan did not work. "The core problem," the paper stated, "is that there is a cash deficit in convertible foreign currency of about VM 3 billion of convertible currency. In 1980, loan repayments and interest payments in convertible foreign currency are to be made to capitalist banks in the amount of VM 12 billion. According to the material of the planning commission, however, only VM 9 billion are available. That would mean that the GDR would become insolvent in 1980."[69] Developments in the capitalist world only compounded the problem. The Staatsbank reported that "drastic increase in interest rates" took place on the capitalist markets in 1979, and interest rates on the Euromarket ran higher than 16 percent for a loan of one year. Expecting the following year rates would be no less than 13 percent, the Staatsbank calculated that these high rates would create a cost of about VM 3 billion for East Germany just to pay the interest on its loans.[70] This aggravated an already precarious situation in the East German balance of payments. A State Planning Commission report in June 1980 commented:

> Even with extraordinary increase in exports, the current level of indebtedness no longer allows the GDR to pay all interest and repayment obligations from its own hard currency holdings because the annual interest and repayment obligations are higher than the annual export earnings. The interest payments alone constitute two-thirds of the export earnings of one year in convertible currency.

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[67] Sekretariat des Ministerrates, "Niederschrift über die Beratung am 3.6.1982 im Ministerrat zu den staatlichen Aufgaben des Volkswirtschaftsplanes, des Staatshaushaltsplanes sowie zur Kreditbilanz 1983," undated, SAMPO, DY 30/25765.
[68] Arrighi, "The World Economy and the Cold War, 1970-1990," 35.
[69] Abteilung der Planung und Finanzen, "Stellungnahme zur Information und den Vorschlägen des Genossen Schürer zur Ausarbeitung des Planansatzes 1980," June 22, 1979, BAB, DE 1/58657.
[70] Staatsbank, "Konzeption für Maßnahmen der Banken zur Beschaffung von Bankkrediten in konvertierbaren Devisen im Jahre 1980," undated (but likely late 1979, early 1980), BAB, DE 10/3067.

The danger stemmed from the possibility that Western banks would no longer extend loans. “If the capitalist banks no longer grant credit to the GDR, the GDR within just a few months would no longer be solvent and could no longer receive imports.”[71] When the East Germans no longer received imports, it would have to make adjustments to the domestic economy, angering the population and raising doubts about the viability of socialism as a means of organizing political economy. Rather than having access to largely unlimited and cheap credit, the Eastern Europeans struggled to find creditors and had to pay interest rates that ranged from 14 to 16 percent.[72]

The second development was the reemergence of China into global capitalism. The untapped Chinese market provided yet another possible destination for money lenders with which Eastern Europe had to compete. Until the 1970s, China had pursued an autarkic economic developmental plan based on central state planning and the mass mobilization of human and natural resources. The death of Mao Zedong in September 1976 allowed Deng Xiaoping to emerge as the new leader, and at the Chinese Communist Party’s Eleventh Central Committee in December 1978, Deng announced his intention to abandon Maoist slogans such as “class struggle” and “continuous revolution.” No longer would class struggle be the guide for China at home or abroad; instead, economic development would trump ideology. “To get rich is glorious,” Deng said.[73]

The Chinese sought to learn from the advanced industrial democracies. Deng said that China was “backward” economically and technologically, and therefore Beijing must “learn

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[71] “Konzeption zum Abbau der Höhe der Verbindlichkeiten der DDR gegenüber dem nichtsozialistsichen Wirtschaftsgebiet vom 27.6.1980,” excerpt of document included with collection of other excerpts dated May 5, 1989, BAB, DE 1/58746, Bd. 1.
[72] Ivan T. Berend, *Central and Eastern Europe, 1944-1993: Detour from the Periphery to the Periphery* (Cambridge: Cambridge University Press, 1996), 231.
[73] Chen Jian, “China and the Cold War After Mao,” in *The Cambridge History of the Cold War, Volume III: Endings*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), 187-88.

from, and take advantage of, the most advanced [achievements] around the world."[74] Deng believed that China badly needed foreign capital to accelerate its development, but he worried that China should not dependent too much on loans; otherwise it would fall too deep into debt. Deng advocated that the Chinese open factories that would encourage the production of labor-intensive goods. He encouraged investment from Taiwan, Hong Kong, Singapore, and South Korea, the most dynamic of the region's economies. U.S. direct investment in the country totaled $2.627 billion by 1986, surpassed only by Hong Kong.[75]

The East Germans worried about what this tectonic development in the course of the Cold War would mean for their ability to raise capital. Polze wrote Mittag in December 1978 that in the past, China had virtually not participated in the capitalist money and credit markets, but now it was "ready to accept credit in huge amounts for industrialization." He indicated that representatives of capitalist banks had expressed their "strong interest" in China, particularly banks in West Germany, Britain, Japan, Italian, and the Netherlands. Polze referenced a recent article in the West German newspaper *Handelsblatt* that the Chinese capital demands of DM 40-50 billion corresponded to the total estimated debt among the Eastern European socialist states. "Such great credit demands could not possibly exist without having an influence on the position of other socialist countries on the credit markets. In fact, the acceptance of loans for P.R. China for large projects could absorb a not-insignificant portion of the remaining liquidity in the capitalist money and credit markets."[76]

Third, confidence within the Western financial community in the viability of economic prospects in Eastern Europe decreased. Polze reported to East Berlin about his trip to the United

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[74] Shu Guang Zhang, *Beijing's Economic Statecraft During the Cold War, 1949-1991* (Washington, DC: Woodrow Wilson Center Press, 2014), 279.
[75] Ibid, 280-88.
[76] Werner Polze to Günter Mittag, "Information für Genossen Dr. Mittag," December 4, 1978, BAB, DN 10/447.

States and Canada in May 1978 to raise capital. He indicated that "in all conversations," the U.S. and Canadian banks attempted to obtain information about the East German balance of payments. "Although in the past the socialist countries paid back their loans punctually, today however there is no absolute trust in the future ability of the socialist countries to pay back" credit. It would only be through the publication of the East German economic figures that the Außenhandelsbank could reclaim the full trust of the Western financial community. The banks acknowledged the importance of stable and continuous economic development, full employment, and the necessity of increasing the standard of living in East Germany, but U.S. bankers nevertheless inquired about "how the GDR, with its rising import prices, poor export opportunities on the capitalist market because of the economic situation, and stable internal prices, planned to balance its trade and payment accounts with capitalist countries."[77] Banks continued to believe that investment in Eastern Europe was prudent, but East German banker Helmut Dietrich reported that in conversations with Western financiers, concerns about the credit worthiness of the socialist states came up "more strongly than before."[78] Bankers want to know if the difficulties of the CMEA countries would be guaranteed by the USSR eventually. When representatives from Fidelity Bank of Philadelphia raised this issue in August 1977, for example, the East Germans curtly responded that the CMEA members were sovereign states that planned to pay back their loans.[79] The unwillingness of the Eastern Europeans to publish their statistics created great clouds of uncertainty in the banking community. The Organization for Economic Cooperation and Development could not even determine how CMEA trade with the developing

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[77] Werner Polze, "Bericht über eine Dienstreise nach den USA und Kanada in der Zeit vom 8. bis 19.5.1978," May 23, 1978, BAB, DN 10/447.
[78] Helmut Dietrich, "Information über die Ergebnisse der Verhandlungen mit den Geschäftsleitungen kanadischer Banken in der Zeit vom 26.10 bis 3.11.1976," November 8, 1976, BAB, DN 10/447.
[79] See, for example, Abteilung 42, "Vermerk über ein am 22.8.1977 mit Vertretern der Fidelity Bank, Filiale London, geführtes Gespräch," August 24, 1977, BAB, DN 10/1677.

world affected their trade deficits with the OECD area.[80] As the tap of finance that had funded East German imports began to slow, East Berlin's ability to provide for its people diminished.

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The Soviets' concentration on access to Western markets and the reorientation of global financial markets away from Eastern Europe had significant implications for the Eastern Europeans. The Poles stood out as the most vulnerable. Like the other Eastern European countries, Poland had embarked on an ambitious policy of rapid growth and industrial modernization in the 1970s through the inflow of Western technology and machinery financed with Western credits. Poor planning and harvests, the oil crisis, and the recession in the West threw a wrench into those plans. Traditionally an energy exporter on the strength of its coal industry, Poland became a net importer by the end of the 1970s. The Polish Minister of Foreign Trade Olszewski admitted to Soviet officials that Warsaw had to pay more attention to improving the quality of consumer goods. When Poland exported to capitalist countries, it found that Polish products lost up to 30 percent of their value because of poor quality.[81] In order to appease its population, the Polish regime resorted to "crack cocaine-style borrowing from the West," in the words of historian Stephen Kotkin.[82]

Despite increasing debts, the Eastern European and Soviet Department in the British Foreign and Commonwealth Office noted that "recent history has demonstrated the necessity for Polish governments to take account of internal consumer expectations, which have been

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[80] Trade Committee, Group on Export Credits and Credit Guarantees, "Financing of East-West Trade," October 6, 1978, Organization for Economic Cooperation and Development Archive, Paris, France, TC/ECG/78.13.
[81] "Informatsiya o vstreche Sovetskoy delegatsii vo glave s tov. Gordeevym B.S. s zam. Predsedatelya SM PNR tov. K. Ol'shevskiy po voprosam povysheniya kachestva i uluchsheniya assortimenta tovarov narodnogo potrebleniya, postavlyaemykh iz PNR v SSSR," undated in 1977, RGAE, f. 413, op. 31, d. 8871.
[82] Stephen Kotkin, *Uncivil Society: 1989 and the Implosion of the Communist Establishment* (New York: Modern Library, 2009), 102.

increasing, despite Poland's problems."[83] Between 1977 and 1980, one-third of Poland's credit was used to subsidize consumption.[84] Inflation ran about eight percent by 1979, and the proportion of Polish export earnings necessary to service Warsaw's debt stood at 70 percent, with the number posed to climb to 85 percent within a couple years.[85] Western banks became increasingly cautious about lending to Poland, though the money kept coming for the time being.

In Poland, the buildup of the sizeable sovereign debt took place under the leadership of Jan Woloszyn, the first deputy president of Bank Handlowy. As the unofficial "financial ambassador to the West," Woloszyn earned the trust of Western financial institutions and raised funds in the industrial democracies to keep the country solvent. "My bank has–I don't know what the highest superlative is–but the highest possible respect for his abilities and integrity," said one European banker. "He's credible, knowledgeable, and he has known for a number of years all the senior bankers taking loan decisions," added another. A third described his virtues as "intelligence, professionalism, an ability to appreciate the other guy's point of view and to keep channels of communication open." Western bankers indicated that Woloszyn's personality alone did not produce loans that were otherwise not forthcoming, but they did suggest that his influence made it significantly easier. "This is a people business," said an American banker. His standing is such that it may sometimes override some of the usual factors in a credit decision."[86]

As the economic situation in Poland continued to deteriorate, however, Woloszyn's ability to raise more capital deteriorated. Poland may not have attempted to reschedule its $18 billion debt, an editorial in *Euromoney* stated, "but it is equally true that disquiet over Poland's

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[83] C.L.G. Mallaby, "The Polish Economy," October 8, 1979, UKNA, FCO 28/3798.
[84] Tony Judt, *Postwar: A History of Europe Since 1945* (New York: Penguin, 2005), 582.
[85] David H. Cohn to Tim Deal, "Working Paper on Polish Economy," January 8, 1979, JCPL, National Security Affairs, Brzezinski Material, Country File, Poland: 1/77-10/78, Box 64.
[86] Nicholas Cumming-Bruce, "Jan Woloszyn's Struggle for Poland," *Euromoney* (October 1980): 100.

debts and its economic performance is growing….In their hearts, banks and governments sense that Poland's problems will get worse, not better."[87]

The way to climb out of debt was painful. Prime Minister Edward Babiuch launched an effort in 1980 to eliminate the Polish trade deficit and pay back capitalist banks. The government repaid about a fifth of its long- and medium term debts (totaling $5.2 billion) as well as $2 billion in interest.[88] First Secretary Edward Gierek and his predecessor Władysław Gomułka had implemented major consumer prices increases in 1970 and 1976, only to be greeted with widespread opposition from the populace. Staggering from the weight of the debts, however, Gierek was forced to raise the price of meat in July 1980. And the Polish people again took to the streets. Workers in Gdańsk, Warsaw, Lublin, and Mielec went on strike; within six weeks, workers from more than 150 factories participated in the demonstrations.[89] As Kotkin writes, "Imagine a state with monopoly control over everything–economy, education, media, cultural institutions, unions, police, the military, entertainment – that could not raise the price of sausage without risking mass social protests. Such was the price of price hikes in Poland."[90] The KOR declared itself a "strike information agency," and shipbuilders in the Gdańsk shipyard formed an unofficial trade union, known as Solidarność (Solidarity). Led by the electrician Lech Wałęsa, Solidarity became the first officially registered independent trade union in Eastern Europe, with a membership of about ten million.[91]

Unlike 1970 and 1976, protests in the summer of 1980 had a political character as well, and insisted on political concessions such as the right to independent trade unions, the right to

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[87] Editorial, "The Truth About Poland," *Euromoney* (March 1980): 5.
[88] Harold James, *International Monetary Cooperation Since Bretton Woods* (New York: Oxford University Press, 1996), 564-65.
[89] William I. Hitchcock, *The Struggle for Europe: The Turbulent History of a Divided Continent, 1945 to the Present* (New York: Anchor, 2003), 304.
[90] Kotkin, *Uncivil Society*, 113.
[91] Judt, *Postwar*, 587-88.

strike without reprisals, and the right to "freedom of expression," among others.[92] Gierek had neither the will nor the means to crush Solidarity. Solidarity was composed of Polish workers, and crushing the movement would undermine the proletarian claim that legitimized the socialism. The Soviets also did not want to intervene, although they helped engineer the ouster of Gierek in favor of Stanisław Kania, a relatively unknown apparatchik.[93] Solidarity and the Polish regime coexisted in a precarious stalemate for the time being.

The economic situation in the country spiraled into an acute crisis. Poland had ceased to exist as a sovereign country. At a meeting of the Soviet Politburo in October 1980, Brezhnev reported on his recent discussions with Kania and other Polish officials:

> They declared that Poland is completely immersed in debt. All imports from the West, which are needed for many enterprises to function as well as for the internal market, are obtained now on credit. *The economy of Poland is directly dependent on the West*. In such circumstances, the Polish comrades believe, any deterioration of the country's situation might provide a basis for the capitalists to refuse any further extension of credits. In that case Poland, according to Kania, will be *brought to its knees*.[94]

Moscow was deeply worried about developments in Poland because Solidarity seemed to pose an existential threat to socialism in Poland and could spread to other countries in the region.

Brezhnev wanted to assist the Polish regime so that the situation would not deteriorate further. Because resources were in short supply, however, Moscow had to reallocate materials originally bound for other members of CMEA. In November 1980, Brezhnev wrote letters to the Bulgarian, Czechoslovak, East German, and Hungarian leadership to warn them about the

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[92] Gregory F. Domber, *Empowering Revolution: America, Poland, and the End of the Cold War* (Chapel Hill, NC: University of North Carolina Press, 2014), 12.
[93] Hitchcock, *The Struggle for Europe*, 306-7.
[94] "Session of the CPSU CC Politburo, 'On the Results of a Visit to the USSR by the First Secretary of the Polish United Workers' Party, Cde. S. Kania, and the Chairman of the PPR Council of Ministers, Cde. J. Pinkowski,' 31 October 1980," October 31, 1980, History and Public Policy Program Digital Archive, TsKhSD, f. 89, op. 42, d. 35, first published in CWIHP Special Working Paper 1. Original available in the National Security Archive RADD/READD Collection. http://digitalarchive.wilsoncenter.org/document/113580. Italics added for emphasis.

dangers of the Polish crisis. "A further deterioration of the situation in Poland threatens to inflict enormous damage on the entire socialist commonwealth," he wrote. The solution was to increase Polish holdings of hard currency and supply Warsaw with extra shipments of a number of goods. Brezhnev proposed to reduce the volume of oil shipments from the Soviet Union in 1981, which would be sold instead on the world market and the proceeds would be transferred to Warsaw.[95] The Eastern European leaders reluctantly agreed. Bulgarian General Secretary Todor Zhivkov, for example, answered two days later, indicating that the Bulgarians understood the need to assist Poland. The Bulgarian Politburo agreed with the Soviet diagnosis of Poland, Zhivkov wrote, and "appraise them as a clear and accurate Marxist-Leninist analysis of the nature, scale, and development of Polish events." He agreed to reduce the amount of oil that Sofia would receive by 400,000 tons to assist Poland. This was a painful step for Zhivkov. "Of course, this is not easy," he wrote. Bulgaria itself "has to solve difficult economic problems. You know this yourself."[96]

Kania told representatives of the Warsaw Pact countries in December 1980 that the Polish government understood the dangers that the uprising posed not just to his country, but to the socialist community more broadly. The crisis aggravated an already precarious economic situation. "Today, the difference between demand and supply is about 20%, and it is rising permanently." From all the Polish calculations, Kania admitted, 1981 would be the third consecutive year in which the national income decreased. "This reflects negatively not only on the living conditions of the people, but also on the state of mind of the Polish population." The

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[95] "Letter from Leonid Brezhnev to Erich Honecker," November 4, 1980, History and Public Policy Program Digital Archive, SAPMDB, ZPA, J IV 2/202-550, first published in CWIHP Special Working Paper 1 http://digitalarchive.wilsoncenter.org/document/112716.
[96] Todor Zhivkov to Leonid Brezhnev, November 6, 1980, Tsentralen Darzhaven Arkhiv (TsDA), Sofia, Bulgaria, f. 378B, op. 1, a.e. 259.

pressure of the foreign debts to the West were crushing, with a total of $26 billion. It would only get worse: Kania said that imports for 1981 would total $10 billion. “Poland is still very strongly dependent economically on capitalist countries, particularly the Federal Republic of Germany and the USA,” Kania admitted. “This situation gives rise to certain threats of a political character.” The United States communicated that if Poland joined the IMF, Kania said, “we will have more advantageous credit terms.” He refused to consider it. Kania did not want to create “a diversion in our family of socialist countries,” and he also feared that if Poland did join the IMF, “certain pressures on us to increase wages on a national scale would once more gain impetus.” As a result, Poland had to turn to the East for aid. “To be able to come out of this difficult economic situation, we need strong help.”[97]

If ever there were a time when Poland needed cooperation from the Western financial community, this was it. The Poles needed to pay off $1.5 billion in 1981 alone. “We need deferrals on credit payments from the capitalist countries,” the Chairman of the Council of Ministers Wojciech Jaruzelski said in February 1981. “With the situation in which Poland finds itself, it is not easy to speak with the capitalist countries.”[98] The Poles had to restore order in the domestic economy. “That includes a correction of the pricing system, however we have to take into account all previous ‘attempts’….We place particular attention on saving more money in all areas. Certainly unpopular measures will be necessary.” Everything must be done quietly, Jaruzelski said, because the “patience of the society has already been strongly tested.” “Poland must reclaim its trustworthiness in the international community,” Jaruzelski concluded.

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[97] “Speech by Stanislaw Kania at Meeting of Party and State Leaders of the Warsaw Pact,” December 05, 1980, History and Public Policy Program Digital Archive, ANIC, Central Committee of the Romanian Communist Party, chancellery, no.5257, 9.12.1980. CWIHP Document Reader, vol.2. "Romania and the Warsaw Pact, 1955-1989" http://digitalarchive.wilsoncenter.org/document/112068.
[98] “Niederschrift über ein Gespräch des Genossen W. Jaruzelski mit Genossen G. Schürer am 26.2.1981,” February 26, 1981, BAB, DE 1/58682.

Regaining the trust of the West would not be easy, but the Poles did have one advantage: Western bankers feared a collapse of the Polish economy. As the *New York Times* pointed out, "If a bank lends you less than a million dollars the bank has leverage over you, but if it lends you more than a million dollars you have leverage over the bank."[99] The West German Foreign Office worried that a Polish default "could lead to a serious disruption in the Western financial system, particularly for the banks that were deeply involved in Poland, and beyond Poland, the entire economic relationship with the East would be severely damaged."[100] On March 27, 1981, Poland suspended principal payments on loans and requested a rescheduling of its $12 billion bank debt. Its total debt at that point stood at a whopping $27 billion (50 percent of GDP).[101] In the spring and summer of 1981, commercial bankers from across the industrial democracies met in Paris to discuss the orderly restructuring of Poland's debt for 1981. Trust in Poland was low. In May 1981, the Polish Ministry of Finance submitted a document to Western banks that projected future trade balances and balance of payments. According to a Western economist, the document appeared barely proof-read with a "highly imaginative mix of 'pure propaganda and wild economic projections.'"[102]

The banks, however, could not afford to lose Poland. At a meeting in Frankfurt, the Western banks offered to reschedule 95 percent of the Polish debt that came due between March 26 and December 31 of 1981, over a period of seven and a half years at an interest rate of 1.75 percent. This so-called "Polish Memorandum" also required, mostly at the U.S. insistence, that the Polish government accept oversight from a Western advisory committee as well as permit a

[99] Ann Crittenden, "Polish Debt Enmeshes the West," May 1981, *New York Times*, D1.
[100] Leiter Planungsstab i.V., "Situation der polnischen Wirtschaft zum Zeitpunkt der Machtübernahme des Militärs," December 15, 1981, PA-AA, B 9 (ZA), Bd. 178494.
[101] James, *International Monetary Cooperation Since Bretton Woods*, 361.
[102] Sarah Martin, "The Secrets of the Polish Memorandum," *Euromoney*, August 1981, 9-15.

technical adviser to "act as an assistant to Polish authorities." This would be "the closest the banks have yet come to assuming an IMF-type role." The Western Europeans doubted whether the Poles would accept this provision. A French banker asked, "Can you imagine that the Soviets will allow an international expert to roam freely in Poland to look at the performance of the economy? Besides, the Poles would find it humiliating."[103]

In the mid 1970s, Western bankers had loaned eagerly to Poland. They believed that they could depend on the Soviet "umbrella" in case Poland ran into trouble. "In practice," however, "the Soviet umbrella is providing only partial cover," *Euromoney* reported.[104] The Soviets also granted Poland a four-year moratorium on its debt, but had to turn Warsaw away when the Poles asked for $700 million. "Of course we can't possibly come up with such a sum," said Ivan Arkhipov, the Soviet deputy prime minister.[105] The Polish crisis caught Moscow in a moment of tremendous weakness. The end of the embargo allowed U.S. grain imports back to the Soviet Union, but the Soviets continued to suffer with their own problems in agriculture. "The 1981 harvest will be the worst in the USSR in years," Baibakov said in September 1981. "It is an open question how the supply for the people will be secured….It will affect the entire five-year plan."[106] At home, the Soviets managed to produce only 180 million tons of grain, in comparison to the planned 236 million tons.[107] Chernyaev lamented that the Soviets "have failed to save the Polish people from hunger." The West had the capacity to help if it wanted, "but we *cannot* even with the best, most brotherly motives. And the whole world is watching this."[108] As Poland

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[103] Ibid.
[104] Ibid, 14.
[105] James Graham Wilson, *The Triumph of Improvisation: Gorbachev's Adaptability, Reagan's Engagement, and the End of the Cold War* (Ithaca, NY: Cornell University, 2014), 50.
[106] Gerhard Schürer, "Information über das Gespräch mit Genossen Baibakow," September 16, 1981, BAB, DE 1/58682.
[107] Ständige Vertretung der Paritätischen Regierungskommission, "Information zur Situation in der Landwirtschaft der UdSSR (Ernte-einschätzung)," September 7, 1981, BAB, DE 1/58682.
[108] Diary entry for August 6, 1981, in Chernyaev, *Sovmestyi iskhod*, 459.

approached bankruptcy, the effects were felt on the ground. Chernyaev wrote, “the stores are empty. Queues for even the most basic products begin at night and, as a rule, return with nothing. Factories, even if we imagine such a fantastic situation as that the workers would want to work, have nothing to work on–there are no raw materials. Imports are barred, as the West pulls its deferred loans. Starvation approaches.”[109]

The Soviets made additional overtures to their allies for more aid. In August 1981, Brezhnev wrote to the Eastern European leaders to inform them that the Soviets would have to release more oil. The Soviets had to sell “substantial quantities of oil and petroleum products to capitalist countries in order to obtain currency to purchase grain and food.”[110] The Soviet Central Committee member in charge of relations with foreign socialist parties Konstantin Rusakov traveled to East Germany, Czechoslovakia, Hungary, and Bulgaria to inform them about Soviet decisions to reduce deliveries. Rusakov reported to the Politburo that Kadar, Husak, and Zhivkov reluctantly agreed with the proposals, but Rusakov said, “my conversation with Cde. Honecker…was different.” Honecker threw a fit, complaining that it would “cause serious damage to the national economy and the GDR as a whole.” Brezhnev noted that the other Eastern Europeans probably felt that way too: “Even if they don't say so directly, they are disgruntled about our decision.”[111] As for Honecker, Brezhnev advised Rusakov, “tell him that I cried when I signed [the order].”[112]

As Poland’s neighbor to the east, the East Germans anxiously watched events unfold. If socialism in Poland fell, Honecker feared, “we have German imperialism in front of us, and

[109] Diary entry for March 28, 1981, in Ibid, 449.
[110] Leonid Brezhnev to Erich Honecker, August 27, 1981, BAB, DE 1/58682.
[111] “Session of the CPSU CC Politburo, 29 October 1981 (excerpt),” October 29, 1981, History and Public Policy Program Digital Archive, TsKhSD, F. 89, Op. 42, D. 48, first published in CWIHP Special Working Paper 1. Original available in the National Security Archive RADD/READD Collection. http://digitalarchive.wilsoncenter.org/document/112801
[112] Quoted in Kopstein, *The Politics of Economic Decline in East Germany*, 94.

would possibly have a capitalist Poland behind us."[113] At a meeting in September 1981, Baibakov told Schürer that Moscow decided to decrease deliveries to all of the Eastern European countries, including Poland, because of agricultural problems. The Soviet decision to decrease oil deliveries to the GDR by 2.2 million tons per year would cost East Berlin almost $1 billion, Schürer calculated. Schürer once again told Baibakov that such a burden was intolerable for the East Germans, who depended on the timely delivery of a fixed amount of oil so that it could power the chemical industry (oil constituted 60 percent of the energy supply in that industry).[114]

A State Planning Commission paper in December 1981 calculated the effects of reduced oil deliveries from the Soviet Union and painted a bleak picture. East Germany consumed 19 million tons annually, the report began, but the Soviets would decrease this amount by 2.2 million tons, a reduction of about 11.4 percent. The oil supply from the Soviets fueled the East German chemical industry, and the State Planning Commission calculated that the decrease would lower East German production by M 1.7 billion. "As a result of the shortfall of these products, the GDR is no longer in the position to meet the envisioned level of exports of oil-dependent products." The drop in oil deliveries came at a particularly inopportune moment. First, East Berlin had to purchase a minimum 1.35 million tons on the world market at a point in time when the oil prices were still reeling from the effects of the second oil shock. "In this complicated situation, the GDR has to do a great deal of business with capitalist companies."[115] In his memoirs, Schalck wrote, "You did not need to be a prophet to predict that less oil would

[113] "Document No. 49: Memorandum of Meeting between Leonid Brezhnev, Erich Honecker, Gustav Husak et al, in Moscow," May 16, 1981, in *From Solidarity to Martial Law*, 283.
[114] Gerhard Schürer, "Information über das Gespräch mit Genossen Baibakow," September 16, 1981, BAB, DE 1/58682.
[115] "Auswirkungen der verringerten Erdöllieferungen auf die Volkswirtschaft der DDR," December 1, 1981, BAB, DE 1/58682.

lead to massive production shortages and therewith export losses. Insolvency loomed–we knew that we could no longer fulfill our credit responsibilities."[116]

The Soviets had intervened in Eastern Europe crises throughout the Cold War, but the context of 1981 was different. They helped replace Kania with Jaruzelski in September 1981, but Moscow did not have the resources to stabilize the situation in Poland. "We cannot take Poland as a dependent," Brezhnev admitted.[117] The Soviets ruled out military intervention. Unlike Prague in August 1968, where reform began at the top, it was the Polish people who challenged the regime. Moscow feared that Soviet military forces would face heavy armed resistance. A Soviet general observed that "the Polish armed forces are battle-ready and patriotic. They will not fire ion their own people."[118] At a Politburo meeting, KGB chief Yuri Andropov acknowledged that the Polish leaders floated the idea of Soviet military support. "We need to adhere firmly to our line," Andropov said, "that our troops will not be sent to Poland." Defense Minister Dmitry Ustinov agreed, saying that "it would be impossible to send our troops to Poland."[119] First Deputy Premier Ivan Arkhipov pointed out, "We are supplying 13 million tons of oil to Poland at 90 rubles a ton. If you bear in mind that the world price for a ton is 170 rubles, that means we are subsidizing the Poles at 80 rubles for every ton. We could have sold all this oil for hard currency, and our earnings would have been enormous."[120]

At a December 1981 meeting of the Soviet Politburo, Baibakov reported his recent meeting with Polish leaders in Warsaw. "The time is now approaching," Baibakov said, when

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[116] Alexander Schalck-Golodkowski, *Deutsche-deutsche Erinnerungen* (Hamburg: Rowohlt Verlag, 2000), 202.
[117] Diary entry for August 10, 1981, in Chernyaev, *Sovmestyi iskhod*, 459.
[118] Ouimet, *The Rise and Fall of the Brezhnev Doctrine*, 200.
[119] "Session of the CPSU CC Politburo, 29 October 1981 (excerpt)," October 29, 1981.
[120] "Session of the CPSU CC Politburo, 26 March 1981 (excerpt)," March 26, 1981, History and Public Policy Program Digital Archive, TsKhSD, F. 89, Op. 42, D. 38, first published in CWIHP Special Working Paper 1. Original available in the National Security Archive RADD/READD Collection. http://digitalarchive.wilsoncenter.org/document/112757

the Poles would have repay their loans from the capitalists. And the Poles were not in a position to do so. The coal industry, the primary sector in which Poland earned convertible currency, "has been severely disrupted…Polish industry is not even coming close to fulfilling its plan." The Gosplan chairman shared that the Poles demanded total assistance in 1982 of goods that totaled about 4.4 billion rubles. When Brezhnev asked whether the Soviets had the resources to make the requested deliveries to Poland, Baibakov responded, "it can be given only by drawing on state reserves or at the expense of deliveries to the internal market." Recognizing the importance of Western financial assistance to Poland, Gromyko admitted that if the Poles cracked down on Solidarity, "the West in all likelihood will not give them credits and will not offer any other kind of help. They are aware of this, and this obviously is something that we, too, have to bear in mind."[121]

Moscow worried that the Poles would resist military intervention, but more importantly that it would lead to Western economic sanctions against the Soviet Union. As the scholar Matthew Ouimet argues, Soviet policymakers became more convinced that its desire to maintain access to Western markets and respect within the international community outweighed preserving communism in Poland at the cost of military intervention. In the Kremlin, policymakers urged Jaruzelski to take firm action to steady the regime's control over events. They understood that the fate of socialism in Poland hung in the balance, and the instability could potentially spread to other parts of Eastern Europe. Even when Moscow became unsure whether Jaruzelski intended on introducing martial law, however, Soviet policymakers believed that military intervention was off the table. "We don't intend to introduce troops into Poland.

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[121] "Session of the CPSU CC Politburo," December 10, 1981, History and Public Policy Program Digital Archive, TsKhSD, F. 89, Op. 66, D. 6, L1. 1-11. Translated by Mark Kramer. http://digitalarchive.wilsoncenter.org/document/110482.

That is the proper position, and we must adhere to it until the end. I don't know how things will turn out in Poland, but even if Poland falls under the control of 'Solidarity,' that is the way it will be."[122] Jaruzelski's dramatic announcement of martial law in December 1981 meant that the Soviets did not have to choose between intervening and allowing socialism in Poland to fall, but discussions in the Politburo demonstrated that Moscow would select the latter, if forced. The era of the Brezhnev Doctrine had ended.

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The Polish crisis had far-reaching consequences. The Soviets could no longer protect the Eastern Europeans. The Soviet five-year trade plan with the Poles had to be abandoned in 1982 because the Polish economic crisis made it impossible to meet its obligations. Moscow extended loans to help Warsaw pay for imports, but it stopped well short of rushing to aid the struggling Polish government. In April 1983, Jaruzelski wrote new Soviet General Secretary Yuri Andropov about continuing economic problems in Poland. Jaruzelski begged for the Soviets to ship another 500,000 tons of grain in the second quarter of 1983; the Poles did not have the means of purchasing it on the world market and traditional exporters such as Canada and France refused to provide it on the basis of credit. He also asked for more gasoline, cotton, and the extension of the Kobryn-Brest natural gas pipeline so that an increased quantity of gas could flow into Poland. Andropov answered coolly, as the scholar Randall Stone notes. He promised to send an additional 350,000 tons of grain, but only in return for a corresponding increase of "goods necessary to the national economy of the USSR." The Soviet leader ignored Jaruzelski's

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[122] Ouimet, *The Rise and Fall of the Brezhnev Doctrine in Soviet Foreign Policy*, 234, 242.

request for gasoline, and deferred decisions of increased cotton deliveries and the prospect of extending the pipeline.[123]

The Polish crisis also marked a turning point in international lending. “The explosive era of lending to the sovereign borrower is ending,” a special edition of *Euromoney* reported in May 1982.[124] “The door of the Euromarket had closed on Comecon: quietly, politely, but firmly.” Western banks decided after the Polish crisis that they would no longer participate in loans to CMEA, and they sought to “cut all exposure to the area by as much as possible.”[125] The deputy director of Gosbank informed Chernyaev that U.S. and other banks refused to lend to the Soviets to pay previous debts or extended offers only at the “inflated” rate of 1/3. Tikhonov worried that the Soviets would have to refuse to pay previous loans. “This is an announcement of bankruptcy, with all its consequences….”[126]

The imposition of martial law also led the Reagan administration to launch a credit boycott against the Eastern bloc, among other punitive actions. The boycott was meant to force the Soviet Union to divert more resources to Eastern Europe, leaving fewer for defense spending. As a Euromoney article put it, “The Reagan administration decided…that the difference between a Soviet invasion of Poland and the imposition of martial was largely semantic, and that economic pressure must be put on the Comecbloc as a whole and the Soviet Union in particular, to prevent further Afghanistans or Polands.”[127] As Poland did not pay banks on time, more and more of the debt rolled over to governments, which had guaranteed the loans in the 1970s to facilitated increased economic interactions between East and West in the spirit of détente. This

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[123] Randall W. Stone, *Satellites and Commissars: Strategy and Conflict in the Politics of Soviet-Bloc Trade* (Princeton, NJ: Princeton University Press, 1998), 109-11.
[124] “The Shunning of the Sovereign Borrower,” *Euromoney*, May 1982, 27.
[125] Padraic Fallon and David Shirreff, “The Betrayal of East Europe,” *Euromoney*, September 1982, 22.
[126] Diary entry for January 28, 1981, in Chernyaev, *Sovmestyi iskhod*, 389.
[127] Ibid, 19.

transition from banks to governments as holders of debt meant that the Poles no longer had any real leverage. While banks could be ruined if Poland did not pay it bank, Western governments could easily withstand defaults. The Poles did not receive any new loans, but their debt continued to grow.

The effects of the end of capital flows to the East reverberated across CMEA. "There have been no offers of credit for half of a year," East German Ministry of Finance official Gerhard Schmitz lamented in March 1982. Capitalist banks referred to the "allegedly high level of debt among the socialist countries, which prevents them from taking on additional 'risks.'"[128] At an April 1982 meeting of the International Investment Bank in Moscow, all delegations from the socialist states commented on the effects of the boycott on their countries. The United States currently directed a comprehensive currency war against the socialist countries, Alkhimov declared, "With a total credit boycott, the largest possible deductions of money deposits, and the ruthless violation of contracts, the goal is to bring about the insolvency of the socialist countries, create economic and political difficulties in these countries, and to discredit the Soviet Union and the other socialist countries." This was part of the larger U.S. overseas strategy toward the East, Alkhimov determined, and Washington placed extreme pressure on its Western European and Japanese allies to follow suit. The Reagan administration had warned Schweizer Bank, for example, that the bank must not continue to extend loans to the socialist countries, and the bank complied with the U.S. order. The United States intimidated many others, as well. Although American allies did not want to follow the same line, Alkhimov believed, "it must be assumed that the capitalist countries will bow to the U.S. diktat."[129]

[128] Gerhard Schmitz, "Information zu einigen aktuellen Fragen der Beziehungen der beiden internalen Banken mit Banken kapitalistischer Länder," March 3, 1982, SAMPO, DY 30/25765.
[129] Horst Kaminsky to Willi Stoph, April 8, 1982, SAMPO, DY 30/25765.

The American financial policy would have serious effects in the socialist community, Alkhimov feared. "This is a completely new and extremely serious situation." The socialist states must "at once decrease their imports radically," and trade must be carried out only with hard currency. Alkhimov intimated that the Soviet Union could no longer offer the other socialist states help in convertible currency. He believed that it was "unavoidable that the living standards of the people would decrease. It is therefore necessary at an early to prepare the people ideologically and psychologically for this situation imposed on us by our adversary in order to avoid surprises and related spontaneous reactions."[130]

Banks "referenced the allegedly high debt of the socialist countries, which did not allow them to take on additional risks."[131] The French Bank Credit Lyonnais indicated to officials in the Außenhandelsbank that because of the debt crises in Poland and Romania, it would look at future deals across the Iron Curtain with skepticism. The GDR did not publicize its balance of payments or the extent of its debt, so the Credit Lyonnais had no means of evaluating risk in the country. "Furthermore, one may not ignore the effects of the massive pressure of the U.S. government on the government of France that drastically limits the trade and credit relations to the USSR and other socialist countries."[132] In the first half of 1982, Western creditors withdrew 40 percent of their short-term deposits in East Germany, including 23 percent in the first five weeks alone.[133] "Private sources of long-term credit to the [Eastern] Bloc have largely dried up," the NIC reported in April 1982.[134]

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[130] Ibid.
[131] Schmitz, "Information zu einigen aktuellen Fragen der Beziehungen der beiden internalen Banken mit Banken kapitalistischer Länder."
[132] Werner Polze to Günter Mittag, March 12, 1982, SAMPO, DY 3023/982.
[133] Steiner, *The Plans That Failed*, 172.
[134] Quoted in Brands, *Making of the Unipolar Moment*, 83.

Cut off from the capitalist markets, the Eastern Europeans mounted what Ivan T. Berend calls an "export offensive" in the early 1980s. They desperately attempted to improve their balance of payments by exporting everything that they could, and limited imports through draconian measures. This "last, bitter attempt to change the economic trend" improved exports by 25 percent, but they exhausted Eastern European reserves.[135] The East German State Planning Commission informed Honecker that it had to decrease the supply of goods to the people, exporting instead M 2.6 billion worth of products. Honecker scoffed at this proposal. "One may not be so light-hearted in the State Planning Commission about providing for the people," Honecker chastised. "One such…interference in supplying the people is intolerable." Honecker pointed to the current situation in Romania as an example of what would happen if the standard of living fell.[136]

Indeed, Romania had embarked on a strict austerity program to lower the debt. The flow of capital began to slow in the early 1980s. In 1981, Bucharest received only two syndicated loans: one from the Arab banks for an $85 million oil-import facility (for a country that used to be Europe's largest oil producer), and a $200 million loan for a canal project. Hard-currency debt totaled $9 billion by the end of 1980, and bankers predicted that it would total $16 billion by the end of 1981.[137] Half of that debt was short-term. Romanian officials tried to sooth Western concerns, telling a group of Western financiers that their struggles would only be temporary. A banker quickly responded, "With a $10 billion hard currency deficit, poor agricultural production, a flagging oil industry, limited coal reserves, the increase of trade with Comecon, and certain political developments which must be taken into account, to say the problem is

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[135] Berend, *Central and Eastern Europe*, 231.
[136] Heinz Klopfer, "Persönliche Niederschrift über die Beratung im Politbüro des ZK der SED am 16.2.1982," February 1982, BAB, DE 1/58654.
[137] "The Next Poland?," *Euromoney*, August 1981, 7.

temporary is stretching optimism to the limits."[138] Sure enough, Romania followed Poland to become the second Eastern European country to seek rescheduling of its debt. In September 1981, the country defaulted.

General Secretary Nicolae Ceaușescu decided that the country needed to turn to austerity to pay back its debts. "We are trying to solve this problem alone, without relying on the usual source of aid, that is, more credits, for which we would have to pay exaggerated interest rates," said Iosif Patan, director for Western Europe in the Romanian Ministry of Foreign Trade.[139] As a propaganda campaign raged about Romania's "golden epoch," villages and many cities went pitch black at night.[140] Ceaușescu exported every available domestic product, hoping to boost exports. As a result, the Romanian populace suffered terribly. Romanians used 40-watt light bulbs, so that energy could be exported to the West for hard currency. Food was rationed. To preserve petroleum, horse-drawn carts became the primary form of travel. Bucharest did manage to pay off its debt, but the austerity program was hugely unpopular among the people; the construction of Ceaușescu's ridiculously ostentatious personal palace known as the "House of the People" clashed with the brutal shortages among the general population.[141] On his visit to Bucharest in June 1987, Mikhail Gorbachev reported that that when he and Ceaușescu met the Romanian people, "their reaction was like a wound-up music box: 'Ceaușescu–Gorbachev!' 'Ceaușescu–peace!'…Later I was told that these criers were brought there on a bus for this purpose. All of this produces an oppressive feeling."[142] Ivan T. Berend notes that "Romania

[138] David Shirreff, "Romania Tries the Bankers' Nerves," *Euromoney*, November 1981, 15.
[139] John Kifner, "Rumania's Enforced Austerity," *New York Times*, December 26, 1983, D4.
[140] Kotkin, *Uncivil Society*, 69.
[141] Judt, *Postwar*, 623-25.
[142] Document No. 13: Report on Mikhail Gorbachev's Visit to Romania," June 4, 1987, in *Masterpieces of History: The Peaceful End of the Cold War in Europe, 1989*, ed. by Svetlana Savranskaya, Thomas Blanton, and Vladislav Zubok (Budapest and New York: Central European University Press, 2010), 253.

escaped from the indebtedness trap but fell into an even deeper poverty trap."[143] Small wonder that the country was the only one within CMEA to have a violent revolution.

The Hungarians (and Poles) broke ranks with the Soviet Union and submitted an application to join the IMF. Budapest had attempted to introduce domestic reform in 1979 with the New Economic Mechanism, allowing greater freedom for private enterprise. The President of the Hungarian National Bank Mátyás Tímár shared that the boycott had forced a fundamental question on policymakers in Budapest. The situation forced them to decide between drastically lowering the standard of living or attempt to receive funding from the IMF. The Hungarians debated submitting an application to join the IMF for several years, and decided to seek membership formally in the IMF in October 1981, without first consulting their allies.

Kádár explained the Hungarian interest in joining the IMF in a letter to Honecker the following month. "Because of its natural and economic position," Kádár wrote, "Hungary is reliant to a large degree on foreign trade. Half of our national income comes from foreign trade, of which half comes from trade with the non-socialist countries." Trade and financial relationships grew with the West "in order for our country's economy to function." Increasing ties with the non-socialist world, however, made Hungary vulnerable to economic disruption in global capitalism. "The known developments in the world economy – the explosive increase in the prices of energy and raw materials – have caused an enormous strain on our economy for the past eight years." He indicated that Hungary had to export 20 percent more goods to pay for the same imports as the period before the 1973 oil crisis. Recently, the Hungarians had struggled to sell their goods to the industrial democracies, a problem compounded by the worsening of credit conditions in the West. After considering all options, Budapest decided to join the international

[143] Berend, *Central and Eastern Europe*, 232.

organizations “in order to secure better conditions for the necessary economic and financial relations with the non-socialist world.” The Hungarians believed that joining the IMF offered the opportunity to balance their accounts with the West, obtain the means to increase exports, and move toward the introduction of the convertibility of the forint.[144]

The Hungarian application to the IMF represented a significant step toward integration with the West and coincided with economic reform. A *Euromoney* article reported in March 1982 that Hungary wanted to prove that it was not another Poland, but that it was “an economy half western half eastern, progressively opening up to world market forces and abandoning the leaky Comecon umbrella, what’s left of it.”[145] Deputy Chairman of the Council of Ministers Jóysef Marjai told British Prime Minister Margaret Thatcher, “Profit must be the incentive. It was not for the Government to hand out money. The Government did not have money.” Thatcher commented that “these remarks could have been made in one of her own speeches.” Marjai continued, stating that Budapest sought to “create conditions in which everyone strove for higher profits. Performance should be the determinant of profits. Production units had to work on the basis of the laws of the market.”[146] The Hungarian economy appealed to the West because it appeared the most responsibly organized in Eastern Europe. The British Foreign Minister Francis Pym concluded, “We wish to support and encourage Hungary because her economy is more sensibly and flexibly managed than those of other East European countries and provides a useful example for them.”[147] The West had no interest in allowing an implosion of the debt situation in Eastern Europe. “If the Eastern European dominoes collectively fall,” the Treasury believed,

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[144] János Kádár to Erich Honecker, November 23, 1981, SAMPO, DY 30/IV 2/2.036/124.
[145] David Shirreff, “Hungary and the Shadow of 1985,” *Euromoney*, March 1982, 132.
[146] “Record of a Discussion Between the Prime Minister and the Deputy Prime Minister of Hungary at 1100 Hours on Tuesday 8 March 1983 at 10 Downing Street,” UKNA, T 439/161.
[147] Francis Pym to FCO, “IMF – Hungary: SBA, CFF and Article IV,” December 1982, UKNA, T 439/161.

"then the task of containing the problems of heavy indebtedness elsewhere in the world will be seriously aggravated."[148] The IMF approved the Hungarian application in May 1982. The legalization of private production and continued access to Western markets transformed Hungary into a mixed economy. This marked the first domino to fall: a policy of liberalization allowed Hungary to receive capital from abroad, this time from Japan. The relationship between access to finance and reform in socialist states was set.

In East Germany, reports of shortages of basic goods became mainstays on monthly SED *Bezirksleitung* reports. Soldiers and the *Volkspolizei* had to be deployed in the Cottbus coal mines to increase production. The Politburo released weapons, ammunition, and raw materials from the state reserves to raise hard currency through emergency measures.[149] "Things at the beginning of the eighties stood on the edge of a knife," Mittag wrote in his memoirs. "The resources to increase economic output became ever smaller, oil deliveries stagnated, and increasingly more had to be paid for the same quantities. In every area, however, there was a growth in consumption. The main argument was securing political stability."[150]

Reflecting on the impact of the Polish crisis, Schalck and König later wrote that the credit boycott created "extraordinary costs" for East Germany. They reported that during the years of the boycott, "all money had to obtained through extremely short-term trade transactions, which led to costs from 35-45 percent per year, sometimes in Export-Import transactions up to 60 percent." With an eye on the boycott's harmful effects, Alexander Schalck-Golodkowski and Herta König developed a strategy within KoKo to raise economic performance by deceiving the State Planning Commission. "In order to ensure the solvency of the GDR under all conditions

[148] Letter to Geoffrey Howe, March 16, 1982, UKNA, T 439/22.
[149] Kopstein, *The Politics of Economic Decline in East Germany*, 94; Alexander Schalck-Golodkowski to Günter Mittag, February 10, 1982, SAMPO, DY 3023/982.
[150] Mittag, *Um jeden Preis*, 82.

and at the same time maintain pressure for export increases and import decreases," they wrote, they had controlled external payments since 1981 according to the "Schalck/König model." Their tactic was to depict the country's economic situation as worse than it actually was. The *Milliardenkredite* (below) allowed the East Germans to once again borrow money from the West at rates ranging from 9 to 20 percent, but they led Schürer to believe that they could only obtain loans at higher rates. Thus, when Schürer sought to achieve his mandate that the State Planning Commission cut the debt in half by 1990, he would set ambitious goals in foreign trade. If the country did not meet those goals, then KoKo could help make up the difference in convertible currency. In 1985, for example, KoKo knew that interest rates dropped from 13 percent to 11 percent. The State Planning Commission, however, made its plans on the assumption that East Berlin could only obtain loans at double the cost. "Under these conditions it can be estimated," Schalck and König wrote, "that in the course of 1986 and 1987 additional savings could be attainable as a realistic target, compared to the planned costs of 23 percent and 22 percent, respectively."[151] When Schürer and his State Planning Commission colleagues developed ridiculous export plans to half the deficit–and those inevitably failed–KoKo would add additional currency from its secret accounts.

The East Germans knew that they depended on the West Germans, not the Soviet Union, to survive. "CMEA was no longer a stimulator [*Impulsgeber*]" for East Germany, Mittag later wrote. "The only way forward was closer cooperation and contact with the Federal Republic, even under the tacit acceptance of the fact that the Federal Republic always offered assistance on the premise that it was preparing for reunification in the future." In the summers of 1983 and 1984, West German Finance Minister Franz Josef Strauss facilitated the government guarantee

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[151] Alexander Schalck Golodkowski and Herta König, "Information," May 14, 1986, BAB, DL 226/1145.

of two credits of DM 1 billion and DM 950 million, respectively (the so-called *Milliardenkredite*). Mittag remembered that Strauss used the West's economic strength to his advantage, identifying it as "a promising way of achieving [Bonn's] fundamental objective" of reunification.[152] By relying on West Germany for a bail out, the *Milliardenkredite* further confirmation that the Soviet Union no longer served as the lender of last resort for the Eastern bloc. Socialism in East Germany only survived as long as Bonn permitted it.

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It was not just that socialism had failed to overtake liberal capitalism in the 1970s; socialism proved unable to even sustain itself as a viable method of political economy. The increasing debts had made capitalists banks nervous about throwing more money to the socialists, and the Polish crisis made the banks finally turn tail and run. The Soviet Union also showed itself to be a unreliable hegemon. Moscow no longer saw military intervention to prop up Eastern European socialists as an effective foreign policy tool; it could no longer afford to do so. As Ouimet notes, the future of socialism in Eastern Europe would have to stand on its own feet rather than with the help of Soviet tanks and bayonets.[153]

At this point, the Eastern Europeans had very few options. They could impose a draconian austerity program on their populations, as the Romanians did. This led to extreme poverty. They could join the IMF, as the Hungarians did, which gave the capitalists a say in the structure of the economy. East Germany received a government loan from West Germany, which only greased the wheels for reunification a few years later. Regardless of which option the Eastern Europeans selected, the promise of socialism had flickered out.

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[152] Mittag, *Um jeden Preis*, 83, 86.
[153] Ouitmet, *The Rise and Fall of the Brezhnev Doctrine*, 243.

Conclusion

After the collapse of détente at the end of 1970s, military tensions between East and West appeared to enter a threatening new phase. The Red Army marched into Afghanistan during Christmas 1979 to protect the soft underbelly of the Soviet Union, eliciting angry protests from the United States and Western Europe. Reagan accelerated a military buildup that had begun under Carter and pushed ahead on NATO plans to deploy intermediate-range nuclear missiles in Central Europe. He rejected the unratified Strategic Arms Limitation Treaty (SALT II) and famously referred to the Soviet Union as the "evil empire" at a meeting of evangelicals in March 1983.[1] NATO installed new missiles in Western Europe in response to the Soviet deployment of new missiles in Ukraine. Vyacheslav Dashichev, a German specialist in the Soviet Academy of Sciences, wrote candidly to his old friend and new Soviet General Secretary Yuri Andropov in January 1983 that "the world is now in an extremely dangerous, critical period which can lead to a new world war. The hopes of nuclear deterrence and certain nuclear annihilation serving as factors to prevent war may prove to be fatal illusions."[2] The war scare during NATO's Able Archer military exercise in November 1983 placed Warsaw Pact units in Central Europe on high alert, bringing the two sides closer to military conflict than at any time since the Cuban Missile Crisis.

These events may have recalled the military tensions that characterized the first two decades of the Cold War, but economic globalization in the 1970s had fundamentally transformed the conflict. Flashpoints such as the Afghanistan War and 1983 war scare may

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[1] Beth Fischer, "U.S. Foreign Policy Under Reagan and Bush," in *The Cambridge History of the Cold War, Volume III: Endings*, ed. by Melvyn P. Leffler and Odd Arne Westad (New York: Cambridge University Press, 2010), 270-1.

[2] "A Top Adviser's Withering Criticism of Soviet Foreign Policy," in *Russia, America, and the Cold War, 1949-1991*, rev. 2nd Edition, ed. by Martin McCauley (London and New York: Routledge, 2013), p.

attract attention from scholars, but they were ultimately epiphenomena and reveal little about why the Cold War ended. The most important development of the early 1980s was that Western capitalism had proven itself superior to Soviet socialism. The ideological competition between Western capitalism and Soviet socialism drove the Cold War and made it distinct from all other great power conflicts. The two ideologies could theoretically be applied to any country in the developed or developing world and provide a model for development. Ideology has played important parts in other conflicts, but at no other occasion did an exportable ideology play such a central role. The underlying racial logic of the British Empire or Nazi Germany, for example, could not be transferred to other nations. In contrast, every country could adopt U.S. democratic capitalism or Soviet socialism. The superpowers did not always live up to their own ideals, but their ideologies promised to embrace all. Theirs was a competition, as the historian Odd Arne Westad has argued, to determine which would provide a higher standard of living. By the 1980s, the race was over. "Socialism came to mean permanent underdevelopment," Westad writes, "while capitalism promised a modernity that worked."[3]

As capitalism recovered from stagflation, the economic failures in Eastern Europe and the Soviet Union meant that the allure of Soviet-style socialism had all but disappeared. With its staggering debts, Eastern Europe could no longer exist without the aid of capitalism. There was no way to return to a closed autarkic development model. The only way forward was to regain the trust of Western creditors, which required structural adjustments and market reform that betrayed the fundamental premise of central planning. As the outcome in Europe became clear, capitalism's success and socialism's failure had ramifications across the world. In a dramatic

[3] Odd Arne Westad, *The Global Cold War: Third World Interventions and the Making of Our Times* (New York: Cambridge University Press, 2007), 403. This dissertation disagrees with Westad's contention that the most important theater of the Cold War was the Third World.

turn, China moved away from central planning and gradually adopted market reforms. New countries in the developing world experimented with similar measures. The turn toward markets in the global South was a symptom of developments in the European theater.

The Cold War ended in 1983 because the ideological competition between capitalism and socialism concluded. The most important showroom for the Cold War was Europe, and the center of the European theater was divided Germany. The most dramatic expression of the end of the Cold War competition was the West German extension of the *Milliardenkredite* to East Germany, a transaction between the two countries on the frontline of the Cold War. The *Milliardenkredite* indicated Bonn's readiness to protect its socialist cousin from financial ruin with an eye on unification. The West Germans continued to focus on unification, and they did not want East Germany to be a broken country when the time to unify arrived. The loans allowed East Germany to limp along for several more years, but it was clear that the keys to the East German economy lay in Bonn.

With the ideological issue resolved, what remained to be done between 1983 and 1990 was to settle the geopolitical denouement of the Cold War. As Eastern Europe moved away from reliance on the Soviet Union and embraced market reforms, would its geopolitical and military orientation change too? Mary E. Sarotte has argued that the German unification negotiations marked a critical point at which East and West struggled to construct a post-Cold War order. The specific timing of the fall of the Berlin Wall on November 9, 1989 was not planned, as Sarotte shows, but the opening of the Berlin Wall and subsequent unification on Western terms was anything but accidental.[4] German unification represented a political event of epic proportions

[4] Mary E. Sarotte, *1989: The Struggle to Create Post-Cold War Europe* (Princeton, NJ: Princeton University Press, 2009); *The Collapse: The Accidental Opening of the Berlin Wall* (New York: Basic Books, 2014).

whose realization was only possible because East Germany emphatically lost its economic battle with West Germany. While German unification required delicate political maneuvering, the outcome aligned unsurprisingly with the interests of the two most powerful players in the negotiations: Bonn and Washington. Soviet and East German economic weakness empowered U.S. and West German policymakers, excluded a Soviet military crackdown, and alienated East German citizens enough in March 1990 to vote overwhelmingly for the Alliance for Germany (consisting of the East German Christian Democratic Union and sister parties).[5] Chancellor Helmut Kohl campaigned February and March 1990 on behalf of the CDU by promising an economic and monetary union between East and West Germany, a platform that promised to extend the fruits of West Germany's economic successes to its struggling eastern neighbor. The Alliance for Germany won almost 50 percent of the vote, validating East German fears over the past two decades that the socialists would lose their ability to rule if they failed to provide a suitable standard of living for their citizens. The reality that capitalism prevailed and socialism faltered provided the context for East-West relations from the mid 1980s until the collapse of socialism in 1989-1991.

Any interpretation of the end of the Cold War needs to explain the revolutions of 1989, and this dissertation concludes that the key to understanding the fall of socialism in Eastern Europe rests with the experience of the 1970s. In light of the 1970s, the "enigma of 1989" is not so mysterious after all.[6] Indeed, it is difficult to conceive a scenario in which a Soviet leader

[5] For an analysis of German unification that emphasizes economic factors, see James W. Davis and William C. Wohlforth, "German Unification," in *Ending the Cold War: Interpretations, Causation, and the Study of International Relations*, ed. Richard K. Herrmann and Richard Ned Lebow (New York: Palgrave Macmillan, 2004), 131-53.

[6] Jacques Levesque, *The USSR and the Liberation of Eastern Europe* (Berkeley and Los Angeles: University of California Press, 1997). Svetlana Savranskaya argues that the Soviet policy in 1989 was the "most rational and reasonable policy to pursue at the time," an interpretation with which this dissertation agrees. Savranskaya believes that the peaceful withdrawal from Eastern Europe followed logically from Gorbachev's thinking and priorities, but this dissertation contends that this line of thinking had been in place for a decade. See Svetlana Savranskaya "The

would have intervened in the 1989 revolutions to bring the Eastern Europeans once again under firm Soviet control. The 1975 price changes had demonstrated that the Soviets were no longer willing to bear the burden of protecting socialism in Eastern Europe at a high cost, and subsidies decreased as Soviet domestic economic troubles mounted. The Polish crisis of 1981 displayed the Soviet Union's inability and unwillingness to carry out military operations in its sphere of influence similar to those in Hungary 1956 or Prague in 1968. The economic costs, both in terms of carrying Poland and potential lost exchanges with the West, were simply too high.

When he entered the Kremlin, Gorbachev provided a new intellectual framework for changing relations with Eastern Europe, believing that Eastern Europe needed to "[walk] alongside us, rather than being towed behind." His program of a democratic Warsaw Pact among equals comported with his conception of *perestroika* at home: more democracy and more socialism. He told a group of officials from the Soviet Foreign Ministry in May 1986 that "the time when we helped them to form their economy, their parties, and their political institutions is past….These are full-fledged states, and we cannot lead them by the hand to kindergarten as we would little children."[7] Gorbachev added more intellectual structure for the Kremlin's treatment of their allies, but in practice little changed. When Eastern European regimes finally embraced austerity in exchange for political liberalization at the end of the 1980s, the Soviets did not intervene. The "Gorbachev Revolution" was not revolutionary for Eastern Europe: Gorbachev's hands-off attitude during the 1989 revolutions marked the logical culmination of a process that had been developing over the past two decades.

Logic of 1989: The Peaceful Withdrawal from Eastern Europe," in *Masterpieces of History: The Peaceful End of the Cold War in Europe, 1989*, 1.

[7] "Document No. 4: Speech by Mikhail Gorbachev to Ministry of Foreign Affairs," May 28, 1986, in Ibid, 224.

This dissertation contends that the West's ability to adapt to economic globalization played the central role in the end of the Cold War. How should historians evaluate the contributions of individual policymakers? The experience of the U.S. government illustrates the fact that mastering the challenges of economic globalization was an iterative process that took time. Often, the Treasury managed to adapt faster than State and the White House. U.S. Secretary of State George P. Shultz, for example, saw a chance to adapt the Bretton Woods international monetary system to the changing realities of transnational capital flows and speculative threats by helping introduce a floating exchange system. U.S. Secretary of State Henry A. Kissinger tended to view world affairs in terms of the Cold War with the Soviet Union and great power politics. The oil crisis in 1973-74, however, alerted him to the political dangers that economic upheaval could pose to alliance cohesion. In a creative period of policymaking, he fashioned a consumer solidarity platform that would confront the oil producers, and also ensure that the divisiveness that had taken place in transatlantic relations during the Yom Kippur War would not happen again. Jimmy Carter stands out for his willingness to take a political hit at the election polls in order to tackle inflation. His appointment of Paul Volcker as chairman of the Federal Reserve played a key role in Ronald Reagan's election in November 1980, but it also put the United States on the road to economic recovery. It stands out as a moment of extraordinary political courage. Many scholars have identified continuity in U.S. foreign policy during the 1970s on the basis of the "absolute centrality of the Soviet Union…in the making of U.S. foreign policy."[8] This dissertation, in contrast, illuminates the continuity in efforts to embrace economic globalization during the Nixon, Ford, and Carter administration in international relations.[9]

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[8] Barbara Zanchetta, *The Transformation of American International Power in the 1970s* (New York: Cambridge University Press, 2014), 11-12.
[9] This interpretation aligns with Daniel J. Sargent's A Superpower Transformed:

Across the Atlantic, several policymakers stood out as seeking to harness economic globalization. While Kissinger struggled to keep the Europeans in line, French Foreign Minister Michel Jobert attempted to use the oil crisis as a platform to launch the Euro-Arab dialogue, a series of conferences meant to bridge the gap between European and Arab positions across a number of issues. In doing so, he sought to give Paris a purpose in world affairs and reestablish the French as leaders on the world stage. While this effort failed, he identified opportunity in the chaos unleashed by the oil crisis and sought to mobilize it. West German Chancellor Helmut Schmidt was perhaps the most able statesman of the era. Sandwiched between two more famous chancellors, Schmidt has been overlooked in the historiography, but he managed to steer the West Germans through the choppy waters of economic globalization. He believed that only collective management of economic globalization could lead to success, and was one of the leaders in establishing the G7 summits as an arena for that to happen. He helped U.S. policymakers facilitate the neoliberal turn in the mid 1970s and resisted French overtures to return to Bretton Woods, believing that the volatility of financial markets made it imprudent. When the U.S. dollar generated more instability in 1977 and 1978 and the Carter administration was unwilling to intervene, Schmidt turned his back on Washington on spearheaded the push for a regional monetary system. He wanted fixed exchange rates in Western Europeans to create certainty in business relationships, while ensuring that the Western European currencies would still float against the turbulent dollar. In fact, Helmut Schmidt's knowledge of the intricacies of international economic affairs was perhaps only surpassed by his desire to tell people how much he knew.

Policymakers in the Eastern bloc did not develop solutions to their myriad problems, but several grasped the nature of the threat that the changing global economy posed to the socialists.

They began to make rumblings about the need to balance their budgets but were overruled by political elites. In East Germany, for example, the chairman of the State Planning Commission Gerhard Schürer and the chairman of the Council of Ministers Willi Stoph understood the dangers that skyrocketing debts to the capitalist banks posed, but General Secretary Erich Honecker consistently beat back any proposal that would improve the balance of payments at the expense of the East German consumer. In the Soviet Union, the most significant link in the Soviet domestic and foreign economy was between agriculture and energy. Few understood this as well as Gosplan director Nikolai Baibakov and chairman of the Council of Ministers Alexei Kosygin. The experience of these East German and Soviet economic officials reinforce the fact that the economic and political histories of the Eastern bloc were intimately intertwined.

The end of the Cold War marked the ascendency of neoliberalism and the empowerment of the market at the expense of the state. That the West triumphed in the Cold War should be beyond dispute: Western capitalism survived, Soviet socialism did not. The victory, however, was imperfect and contained seeds of future crises. The turn to the market eliminated social safety nets for millions of people and accelerated global inequality. The United States transformed from a nation from which money and resources flowed to the rest of the world, to a country that depended on the import of resources from abroad. This debt bubble burst during the financial crisis of 2007-08. The virtues of economic globalization have been brought sharply into question in recent years. Accelerating economic interdependence was not some inexorable force moving forward in the 1970s, and analysts should not be surprised that a reversal is possible. During the 1990s, scholars talked about the end of the Cold War as tantamount to the “end of history,” but the Great Recession proved that Western capitalism is no utopia.

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