
**“Please Better Shut Their Mouths”:
German Influence on U.S.
Macroeconomic Policy under the
Carter Administration**

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Abstract

Over the late 1970s, U.S. macroeconomic policy underwent a major shift, rejecting incomes policies and accepting macroeconomic restraint as the primary means to holding down inflation and strengthening the dollar. In conventional narratives, this shift is cast as a response to the diminishing effectiveness of incomes policies and the fundamental importance of macroeconomic restraint in maintaining monetary stability. However, such accounts obscure the interpretive context in which these shifts occurred, as beliefs regarding the limits of incomes policies and the need for restraint took on “lives of their own.” In this paper, I examine the intersubjective context of these policy shifts, addressing not only the domestic context of debates over wage-price trends, but also German pressure on U.S. policy, and the key influence of Chancellor Helmut Schmidt in urging U.S. oil deregulation and monetary restraint. I specifically highlight interactions in the context of the 1977 London and 1978 Bonn summits and the 1979 World Bank-IMF meetings. Taken as a whole, this effort highlights the intersubjective context of domestic-systemic debates, as liberalizing pressures reflected not only domestic pressures from within U.S. society but also external German influences, as together mediated by key U.S. policymakers.

In the late 1970s, as the Democratic Carter administration confronted intensifying trade-offs between price stability and full employment – and so between dollar stability and growth – the U.S. abandoned the use of incomes policies and adopted macroeconomic restraint as the primary means to currency stabilization. Subsequently, incomes policies – defined as standards for variation in wages and prices – would be decisively discredited as policy instruments.¹ In this paper, I offer a constructivist analysis of the evolving debates which drove this transformation, emphasizing the interplay of domestic shifts and foreign pressures stemming from German Social Democratic Chancellor Helmut Schmidt in particular.² In the process, I counter views of incomes policies as inherently flawed, suggesting instead that what “everybody knows” about prospects for private wage and price restraint on behalf of the public good can have a self-reinforcing effect on the viability of incomes policies. In other words, “how agents think” about economic policy can affect “how policies work.” From this vantage, over the early post-World War II period, collective trust in possibilities for the exercise of private wage and price restraint on behalf of the public good enhanced the effectiveness of incomes policies. In contrast, by the late 1970s, collective skepticism in prospects for private wage and price restraint assumed the force of a self-fulfilling prophecy, as the social fact that “everybody knew” that incomes policies did not work undermined support for their use. Restraint was

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¹ Purchasing power parity models posit a link between price and currency trends.

² With respect to case selection, Carter and Schmidt *each* led the main liberal or “left-of-center” parties in their respective political systems, and so this analysis demonstrates the intersubjective influences upon not only coalitional interests but also partisan preferences. See Wendt (1999) on interests as beliefs.

left the sole means to wage, price, and currency stability.

Following an explicit overview of a revised constructivist framework – one stressing in particular the interplay of mass and elite discourses – I trace over three sections the their influence on late-1970s U.S. macroeconomic policies. In a first section, I address the domestic context of early Carter-era policies, characterized by a halting movement toward incomes policies that culminated in an ultimately failed October 1978 attempt at defining wage guidelines. In a second section, I pull back to examine the systemic context of U.S.-German interactions across the London and Bonn economic summits, as the Carter administration shifted to a phase of support for gradual austerity in November 1978. In a third section, I describe the social forces that compelled a shift of U.S. policy toward support for unqualified fiscal and monetary austerity. It should be stressed that the fact that the dollar was losing value over these periods did not in itself compel a U.S. tightening. Instead, incomes policies might have served as ongoing means to bolster the dollar. However, the socially-governed collapse of trust in government *within* the U.S. undermined popular support for voluntary wage and price guidelines. In this context, Federal Reserve Chairman Volcker would subsequently employ unqualified monetary restraint as the primary means to stabilization. Schmidt's influence on Volcker was particularly important, as he expressed to the Chairman a marked impatience with U.S. policies prior to the late 1979 IMF-World Bank meetings. Writ large, to the extent that incomes policies remained an ongoing possibility over this period, their breakdown cannot be understood in abstraction from an evolving social context.

Theoretical Overview: The Social Construction of Macroeconomic Interests

In explaining the breakdown of incomes policies, a variety of materialist approaches emphasize either their basic economic inefficiencies or the gradual erosion of their postwar coalitional, institutional and/or ideational bases of support. However, such explanations are inadequate to the extent that economic structures can vary and as policy incentives must always be interpreted in terms of some intersubjective framework. Consider first economists' criticisms of incomes policies as impediments to efficiency that at best suppress inflation and at worst undermine growth and price stability. Such views admittedly have some merit in the context of *perfectly* competitive markets. However, they lose force where *imperfect* competition enables firms to restrict output in order to raise prices. In such settings, incomes policies offer both a means to restrain prices and raise output, *and* so provide a key contribution to the "policy mix" as alternatives to macroeconomic restraint. Consider more fundamentally still that economists' arguments lose added force where self-reinforcing expectations drive wage-price spirals, as wages and prices lose contact with underlying market forces.

From a more explicitly political vantage, consider approaches which emphasize the coalitional or paradigmatic bases of macroeconomic preferences. Regarding the former, scholars like Peter Gourevitch argue that postwar shifts in political alignments reduced the ability of labor to support Keynesian policies, which were premised on some degree of capital-labor accord (Gourevitch, 1986). Regarding the latter, scholars like Kathleen McNamara argue that the ostensible mid-1970s collapse of the Phillips Curve trade-off undermined Keynesian frameworks, leading economists to place an increasing emphasis on monetary restraint (Hall 1989; McNamara 1998). However, such arguments remain wanting to the extent that they abstract away from the social context. With respect to coalitional arguments, representatives of labor and capital can define their interests in varying fashions,

seeking to advance private interests in wage and profit gains or public interests in macroeconomic stabilization. Similarly, economists can interpret identical wage-price trends in a range of fashions. The “impossible” emergence of simultaneously increasing unemployment and inflation could justify *either* the intensification of incomes policies (as in the 1950s, when the combination of rising unemployment and prices was termed a “New Inflation”) *or* their dismantling in favor of monetary restraint (as in the late-1970s context examined here). More specifically, the degree of trust of government can vary in ways which affect such coalitional and paradigmatic attitudes alike. Consider that the percentage of Americans saying they trusted the government “just about always” or “most of the time” fell from 73 percent in 1958 to 25 percent in 1980.³ To the extent that the extent of trust in government can have self-reinforcing implications for the effectiveness of public appeals to wage-price restraint, this social context – as a “social fact” – can have an objective impact on the effectiveness of incomes policies. In more formal terms, where “social facts” regarding trust in government change, coalitional and paradigmatic interests can likewise vary.

To highlight such potential variation in ideas and interests, I provide in this effort a constructivist analysis of shifting interests in the use of incomes policies. In recent decades, recognizing the limits of approaches which treat material structures or trends as self-evident, scholars arguing from a broadly constructivist vantage have stressed the role of intersubjective forces in giving meaning to incentives and shaping interests in cooperation. In what might be termed “first generation” constructivist efforts, scholars like John Gerard Ruggie and Peter Katzenstein emphasized the intersubjective and institutional bases of state and societal interests

³ Trust the Federal Government, 1958-2004 *The American National Election Survey Guide to Public Opinion and Electoral Behavior*
<http://www.electionstudies.org/nesguide/text/tab5a_1.txt>

(Ruggie, 1982; Katzenstein, 1978). However, while such efforts provided a key alternative to materialist approaches, they also exhibited something of a “structural tilt,” and were often better suited to explaining *stability* than change. In this light, over the 1990s, a second generation of constructivist scholars sought to highlight the role of agency and expressive practices in driving change. These included efforts by Peter Haas and Emanuel Adler on elite epistemic communities and Martha Finnemore and Kathryn Sikkink on the role of “norm entrepreneurs” in driving change.⁴ Nevertheless, while representing an important step forward in highlighting the scope for agency, these efforts often cast intersubjective pressures as moving primarily in one direction, from elite to mass settings. They therefore remained limited not only to the extent that intersubjective structures often remained beyond the scope of elite manipulation but also as elite debates themselves could be shaped by mass pressures.

To highlight the broader mass influences, a “third generation” of constructivist scholars has accordingly sought more recently to go beyond the analyses of elite debates and to highlight the influence of what John Hobson and Leonard Seabrooke term “everyday politics.” These efforts have stressed the extent to which “ideas” cannot be simply reduced to cognitive paradigms imposed by elites upon mass agents, but rather encompass wider traditions, frequently developing outside specific issue areas or formal policy contexts. Such broader mass-oriented influences can include definitions of national and cultural identities, attitudes regarding class, consumption and thrift, norms regarding civil and economic rights, emotional and social psychological forces, and – the focus of this

⁴ Finnemore and Sikkink (1998, 895-897) have argued that norm entrepreneurs engage in framing practices that “call attention to issues or even ‘create’ issues,” succeeding when an initial stage of norm emergence passes over a “tipping point” into norm cascade and new frameworks come to “resonate with broader public understandings.”

effort – broad tendencies to trust in government (Sucharov 2005; Ross 2006; Seabrooke 2006, 2007; Hobson and Seabrooke 2007; Goff 2007). Indeed, despite an arguable tendency of constructivists to overemphasize the importance of elite paradigmatic debates, mass inclinations often themselves shape elites' own attitudes.

The analysis in this effort builds on these insights regarding the interplay of mass and elite pressures by highlighting the role of key agents – termed “norm mediators” – who synthesize mass and elite discourses and seek to minimize social dissonance between elite and mass views. This notion of “norm mediators” is meant to contrast with the Finnemore and Sikkink notion of “norm entrepreneurs,” as mediators engage not only cognitive concerns, but also wider emotional and affective discourses. In this effort, in identifying the most important such mediating agent, I highlight the importance of presidential leadership and the increasing role in economic debates of the Federal Reserve Chairman. Each of these agents synthesizes and channels varying mass attitudes, elite views, and systemic discourses.

However, before applying these insights to explain late-1970s shifts in U.S. policies, it is worth making some final points with respect to research design: First, the economic realm poses a “least likely” case for constructivism, as agents possess access to substantial volumes of well-organized data. If agents cannot make efficient use of data in this realm, such efforts would seem to be more difficult in other issue areas. Secondly, the U.S. polity stands as a hard case, as its ostensible liberal, individualist nature might seem to render it less suited to egalitarian stresses on the public interest which serve as a prerequisite to the use of incomes policies. Finally, to the extent that Carter and Schmidt each led the more prominent liberal or “left-of-center” parties in their respective political systems, this analysis highlights the influence of larger intersubjective

contexts in shaping partisan and coalitional interests themselves.⁵

The Domestic Context: Three Shifts in Carter Policies

In the 1976 presidential campaign, concerns for economic growth led the Carter campaign to place its macroeconomic stress on promoting recovery and reducing unemployment. Neither inflation nor the dollar was seen as a pressing concern, given the weakness of the economy, and the Carter campaign saw little need to court controversy by seeking standby authority to set wage-price guidelines. One campaign paper noted that an expansionary policy could “reduce unemployment without reigniting inflation, because our economy is presently performing so far under capacity” (Biven 2002, 36-37). In December 1976, Carter explicitly declared he had “no intention of asking the Congress” for the authority to impose mandatory controls (Haas 1992, 87-95). Carter CEA Chairman Charles Schultze later recalled that, “the theory was that we needed something to get us going. The economy is going to recover, but it is going to be slow. We need it to be going fast.”⁶

This stress on recovery would later be recognized as an overreaction, not least by Carter officials themselves. Carter aide Stuart Eizenstat would lament the failure to lay the foundation for an incomes policy, arguing that “we should have sought wage and price control standby authority in 1977 as the President had suggested he would do in the '76 campaign and in his White Paper on the economy. And he was persuaded by his economic advisors not to do that because they said it would be too

⁵ On “least likely” cases, Eckstein (1975) argues that establishing the primacy of variables in unlikely settings increases confidence regarding their influence in more favorable contexts, enabling one to better generalize from fewer cases.

⁶ Interview with Charles Schultze, Miller Center Interviews, Carter Presidency Project, Vol. XI, January 8-9, 1982, p. 27, Jimmy Carter Library

anticipatory a wage/price behavior.”⁷ Schultze later argued that the administration had been “always, in terms of an anti-inflationary program, six months to a year behind the game.” He credited not only the fear of sparking an anticipatory price rise, but also the continued opposition of labor and George Meany to guidelines or controls. Schultze later recalled that “Initially (Secretary of Labor) Marshall and some of the others sold the President on the idea that incomes policy was a dirty word and guidelines were dirty words and all that, so to whatever extent they would have done any good, they were late” (Hargrove and Morley 1984, 479-480). Schultze described the administration’s dilemma more explicitly, arguing that the “central economic problem... was how do you reverse a stubborn inherent inflation without stifling the economy?” While austerity would accomplish the task of maintaining price stability, it would do so at the cost of undermining growth. Schultze later suggested that he had told Carter that if “[y]ou give me the charge... I’ll get rid of inflation for you in two years... by putting the economy through a wringer.” However, for the Carter administration the problem was “we [didn’t]... want to do that.”⁸

One might in fact argue that Carter officials inverted the prior Ford administration’s mistake of underestimating recessionary possibilities, instead underestimating inflationary dangers. For this reason, the administration initially emphasized the need for a stimulus package, rather than preparing for the eventual reemergence of inflation. However, by April 1977, recognizing signs of economic revival, Carter scaled back his stimulus package, eliminating a \$50 tax rebate and offering instead his administration’s first anti-inflation package (Biven 2002, 77; 82-83). However, because his advisers

⁷ “Stuart Eizenstat exit interview,” <http://www.jimmycarterlibrary.org/library/exitInt/exitstu.pdf>

⁸ Interview with Charles Schultze, Miller Center Interviews, Carter Presidency Project, Vol. XI, January 8-9, 1982, p. 2, Jimmy Carter Library

ruled out controls, guidelines, or austerity, this left only vague exhortation as a means to restraint: Carter requested that Congress reauthorize the Council on Wage and Price Stability, stressed the need for deregulation to increase competition, and announced the formation of a labor-management committee. Nevertheless, inflation accelerated and pressure on the dollar mounted. Over the first half of 1977, inflation increased by about 9 percent, attributed to increasing food prices, an inflationary settlement in the coal industry, and slowed productivity growth (ibid., 133-5). Even Chairman Schultze later conceded that the April 1977 program “had all kinds of bits and pieces in it, none of which meant anything”⁹

This led to the administration’s second exhortative attempt at monetary stabilization, as it called for a “deceleration” of wage and price increases, with the government itself leading the way by example. Introduced in the 1978 *Economic Report of the President*, this deceleration program would be formally unveiled in an April 1978 Carter speech to American Society of Newspaper Editors. Carter declared himself “determined... to take the lead in breaking the wage and price spiral by holding Federal pay increases down” and accept “a limit of about 5½ percent this year... setting the example for labor and industry” (Biven 2002, 137). Perhaps ironically, business would prove more receptive than labor, as key automobile, aluminum, and steel producers publicly affirmed their support. In contrast, as Labor Secretary Ray Marshall and Inflation adviser Robert Strauss noted in a presidential briefing, “the unions are skeptical of the potential effectiveness of the Administration’s anti-inflation policy [and]... unwilling to practice wage deceleration prior to any indication of a slowdown in price inflation” (Biven 2002, 138).

⁹ Interview with Charles Schultze, Miller Center Interviews, Carter Presidency Project, Vol. XI, January 8-9, 1982, p. 32, Jimmy Carter Library.

In October 1978, Carter responded to continued inflationary pressures with a third major stabilization package. While opposing controls as “a complicated scheme of Federal government wage and price controls on our entire free economic system” and similarly opposing “deliberate recession,” Carter stressed the need for government to “take the lead in fiscal restraint.” Carter also suggested that “[g]overnment cannot do the job alone” and that “the success or failure of this effort will also rest on whether the private sector will accept – and act on – the voluntary wage and price standards I am announcing tonight.” Stressing the role of self-fulfilling expectations in driving inflation, Carter argued that:

In the last 10 years, in our attempts to protect ourselves from inflation we've developed attitudes and habits that actually keep inflation going once it has begun. Most companies raise their prices because they expect costs to rise. Unions call for large wage settlements because they expect inflation to continue. Because we expect it to happen, it does happen; and once it's started, wages and prices chase each other up and up. It's like a crowd standing at a football stadium. No one can see any better than when everyone is sitting down, but no one is willing to be the first to sit down.

Carter also suggested a new innovation in this address, in a taxed-based incomes policy (TIP) to counter inflationary wage increases. This would provide a market-based hedge against inflationary wage settlements.¹⁰

¹⁰ Jimmy Carter, “Anti-Inflation Program Address to the Nation” October 24, 1978
<<http://www.presidency.ucsb.edu/ws/index.php?pid=30040&st=&st1=>>

However, leaks and skepticism regarding complicated nature of the TIP approach – with its implications for increasing the complexity of the tax code – engendered a negative public reaction. Indeed, according to Schultze, the Council of Economic Advisers itself had “a very lukewarm to negative attitude on the TIP.” Initially, Schultze recalled, Carter aide Robert Strauss embraced the notion because it was “the only new thing we have and everything else in this package has been leaked but this is a marvelous idea. We have a new Carter initiative.” Yet, once announced, Schultze found that the reaction ranged from “an absolute lukewarm to hostile reception.” Once Treasury Secretary W. Michael Blumenthal withdrew his support, the package collapsed (Hargrove and Morley 1984, 496-497). Inflation advisor Alfred Kahn later elaborated that “we fought very hard for real wage insurance.” However, “[l]abor was opposed and business was opposed.”¹¹ The days following Carter’s address saw the U.S. stock market fall and the AFL-CIO denounce the administration proposal. Yet, even these domestic reactions were not sufficient to spur an abandonment of the package. It would take an international reaction, as the dollar continued to fall, to force the administration’s hand and begin the shift to reliance on austerity. In the domestic absence of the trust that might have sustained the October 1978 wage guidelines, systemic anxieties regarding the dollar increased, and austerity became more necessary to stabilize its value. The dollar’s decline in this light cannot be understood in abstraction from an evolving domestic context.

The Systemic Context: Summits and Macroeconomic Debates

¹¹ Interview with Alfred Kahn (including Ron Lewis, Denis Rapp), Miller Center Interviews, Carter Presidency Project, Vol. IX, December 10 and 11, 1981, pp. 95-96, Jimmy Carter Library

In the international realm, as in the domestic setting, the administration's first concern had been to overcome the 1975-76 downturn. To do so, it advocated an international "locomotive" agreement for a coordinated macroeconomic expansion. In January 1977, Vice President Mondale toured Europe and Japan to secure support for this approach (Biven 2002, 91-92). Initial responses were not encouraging, however, as German leader Helmut Schmidt proved resistant to a stimulus. Dismissing the Carter initiative, he argued that U.S. officials should "please better shut their mouths," and stressed the dangers of inflation (Cooper 1989, 130). During one session, Schmidt explicitly praised the prior Ford administration Treasury Secretary William Simon, asserting that "We owe a lot to Bill Simon," only to have Mondale respond "We owe Bill Simon everything...without him we wouldn't have won the election" (Biven 2002, 98-99; 102).

Against this backdrop – paralleling the Carter administration's early abandonment of its domestic stimulus – the first attempt at a locomotive initiative proved a disappointment. The May 1977 London economic summit failed to produce accord on the timing and magnitude of any coordinated expansion. While German officials resisted pressures for a stimulus, U.S. officials found their own hand weakened, as Carter had himself abandoned his earlier domestic stimulus. This in turn helped to enable Schmidt to include in the summit communiqué a statement stressing the primacy of combatting inflation, urging that "Inflation does not reduce unemployment. On the contrary, it is one of its major causes" (Smith 1994, 191).

Nevertheless, as European worries about growth would themselves intensify, possibilities for a broader agreement would improve. In this context, by spring 1978, following a meeting with Schmidt, Carter aide Henry Owen relayed to Carter that the Chancellor "accepts the notion of a [stimulatory] package approach

suggested in your letter to him.” In return, Owen noted that Schmidt

...stressed the need for effective U.S. anti-inflationary action to strengthen the dollar; he said he realized from his own experience both how painful such measures were bound to be politically in the U.S., and how necessary it was to stick with them, year in and year out, if inflation was to be brought under control...

According to Owen, Schmidt further added that, given global imbalances, “nothing would do so much to enhance European confidence in U.S. leadership as effective action to limit oil imports” (Biven 2002, 147). Against this backdrop, at the July 1978 Bonn summit, the German government agreed to take measures to boost aggregate demand, while the U.S. reciprocated by pledging to reduce inflation and oil imports. However, after the summit, Carter officials came to fear that these U.S. commitments might prove contradictory, as oil price decontrol might engender higher prices, feeding wage demands. Following Bonn, Carter appointed Cornell economist Alfred Kahn his inflation adviser, a position which entailed frequent efforts at “jawboning” and attempts at encouraging labor and business to accept the need for wage-price restraint. Kahn was particularly aware of labor concerns with the Bonn accord, recalling that UAW leader Douglas Fraser informed him that “If you people deregulate crude oil, you can kiss your [wage] standards goodbye. If you make my workers pay a dollar for gasoline then I’m not going to stick to the wage standards” (ibid., 165). In the midst of such tensions, the dollar continued to slide following the summit. In earlier contexts – from the late 1950s Eisenhower administration concerns for the rising “dollar surplus,” through Kennedy administration efforts to maintain both the dollar and the pound, through the Nixon administration’s 1971

“New Economic Policy,” an immediate policy step in the face of currency troubles had been to intensify incomes policies and call for the exercise of “shared responsibility” by capital and labor. However, in the late-1970s social context, the dubious response to the October 1978 guidelines – which Carter himself feared would “be laughed at” – compelled the abandonment of such institutional habits (ibid., 169). On November 1, as noted above, the administration assembled a second dollar rescue package, employing \$30 billion in foreign exchange to support the dollar and – in a coordinated move with the Federal Reserve – a 1 percent increase in the discount rate. In announcing these initiatives, Treasury Secretary Blumenthal and newly-installed Federal Reserve Chairman G. William Miller declared in a joint statement that “movement in the dollar exchange rate has exceeded any decline related to fundamental factors, is hampering progress toward price stability and is damaging the climate for investment and growth.”¹² Indeed, in assembling this plan, Carter had been particularly impressed by the argument that an erosion of systemic confidence in the dollar would undermine price stability at home (Biven 2002, 170).

The October-to-November shift marks a significant change, as falling confidence in incomes policies spurred recourse to monetary restraint unaccompanied by any sort of incomes policy. Indeed, monetary austerity was seen as so crucial that administration officials ironically pressed the Federal Reserve for *higher* interest rates, which the Federal Reserve in turn resisted. Schultze later recalled that “at the turn of the year 1978-79, Blumenthal and I carried on a leaked campaign in the press to try to pressure Miller into tightening up. There were leaked stories about how

¹² Jimmy Carter and W. Michael Blumenthal, “Value of the Dollar in Domestic and International Markets, Remarks Announcing Measures To Strengthen the Dollar,” November 1st, 1978
<<http://www.presidency.ucsb.edu/ws/index.php?pid=30084&st=&st1=>>; *Washington Post* 2 November 1978, A5.

administration officials think the Fed ought to tighten up – normally its the other way around – and we got a very nasty note at one time in effect, saying, lay off” (Hargrove and Morley 1984, 486). One such memo to the Treasury Secretary and CEA Chairman came from Carter himself, as he wrote: “I think the little 2-week news media crusade to force Fed action is unnecessary and improper. In the future, remain silent on what the Fed might do unless I specifically approve any so-called leaks” (Biven 2002, 144). Over the next year – in the context of declining domestic and systemic confidence in incomes policies – Carter would move further still in the direction of supporting both monetary and fiscal austerity.

Systemic and Domestic Convergence: To Macroeconomic Restraint

In the absence of incomes policies, and in what Carter himself interpreted in a major public address as a “crisis of confidence,” the shift to reliance on macroeconomic restraint would accelerate. That Paul Volcker’s appointment as Federal Reserve Chairman was initially something of an afterthought speaks to the magnitude of the subsequent expansion of the Chairman’s role. Volcker’s emergence is best situated in the context of Carter’s July 1979 construction of a “crisis of confidence” facing the United States. In a nationally-televised July 1979 address, Carter argued that Vietnam and Watergate had eroded popular faith in the ability of “citizens to serve as the ultimate rulers and shapers of our democracy.” Highlighting foreign pressures as well, Carter argued, “We remember when the phrase ‘sound as a dollar’ was an expression of absolute dependability, until ten years of inflation began to shrink our dollar and our savings.”¹³ Yet, while the

¹³ Jimmy Carter, “Energy and National Goals Address to the Nation,” *Public Papers of the President*, July 15, 1979

speech was initially well-received, Carter failed to capitalize on it, and further exacerbated post-address anxieties by requesting the resignation of his entire cabinet. While most officials were retained, Carter dismissed Treasury Secretary Blumenthal and replaced him with Federal Reserve Chairman G. William Miller. This opening at the Federal Reserve occurred during a period in which Carter – following his request for his cabinet’s resignations – was rapidly losing the confidence of financial markets. In a rush to find Miller’s successor, Carter appointed Paul Volcker, who favored a greater reliance on austerity.¹⁴

Volcker’s appointment occurred at a moment when this increasing support for monetary restraint was reinforced by diminishing allied confidence in the dollar. Recalling that administration officials accompanying him to an October 1979 IMF-World Bank meeting “were not enthused” with his ideas regarding the need for restraint, Volcker later recalled that he would receive “psychological reinforcement when we stopped off at Hamburg, hometown of Helmut Schmidt, who... dominated the conversation and left no doubt that his patience with what he saw as American neglect and irresolution about the dollar had run out” (Volcker and Gyohten 1992, 168). Indeed, in September 1979, the IMF would explicitly reverse its views on “gradualist” anti-inflation policies, condemning them as inadequate, and urging tougher monetary and fiscal policies (International Monetary Fund 1979).

Subsequently, having initially encountered resistance within the Federal Reserve to the discrete interest rate increases he felt necessary to accomplish the requisite slowdown, Volcker adopted as a tactical device a shift

<<http://www.presidency.ucsb.edu/ws/index.php?pid=32596&st=&st1=>>

¹⁴ The lack of reflection on the Volcker appointment was noted by William Greider, who recounts how Carter’s former adviser Bert Lance warned that “[i]f [Carter] appoints Volcker, he will be mortgaging his re-election to the Federal Reserve.” Greider 1997, 47.

in the Federal Reserve's operational approach, directly targeting the money supply.¹⁵ Put bluntly, by restricting the supply of credit, the Federal Reserve would raise its price. In early October 1979, while the Federal Reserve announced an increase in the discount rate, it more importantly declared that it would be placing a much "greater emphasis on the day-to-day operations on the supply of bank reserves and less emphasis on containing short-term fluctuations in the Federal Funds rate." In shifting to a monetary rule, rather than interest rate target, the Fed further conceded that "wider day-to-day or week-to-week fluctuations in the Federal Funds rate may occur."¹⁶

Volcker's shift to a monetary rule had significance beyond material trends.¹⁷ Volcker had accepted Neoclassical and Classical constructions of stagflation which held that it had "been picking up since the Vietnam War period" and that it had been caused primarily by excessive macroeconomic accommodation (Volcker and Gyohten 1992, 164). Against this societal backdrop, Volcker engaged in a bit of norm mediation of his own, as he ratcheted together the mass-oriented post-Vietnam distrust in government with elite-oriented paradigmatic arguments regarding the importance of government (i.e., monetary) policy failings in causing

¹⁵ Schultze later cast Volcker's adoption of a monetarist rationale as politically-necessary, partially insulating the Federal Reserve from criticisms regarding high interest rates. Schultze recalled that "Volcker was absolutely dead right on the politics of it... if the Fed had gone about doing it the way it used to do every month picking the federal funds target, then, in the eyes of the public, the Fed would have been driving those rates up. And the genius of what Volcker did, during the period when you had to get the public used to this, was to adopt a system which came to the same thing, but in which he said we are not raising interest rates, we are just setting a non-inflationary path for the money supply, and the markets are raising interest rates. Quoted in Biven 2002, p. 242

¹⁶ *New York Times* 8 October 1979, D6.

¹⁷ Although Burns had revised Federal Reserve procedures to place a greater stress on monetary aggregates in 1970, this had little impact given the lack of public concern. Wojniwoler 1980, 288.

inflation. Volcker asserted that individuals “don't need an advanced course in inflation to understand that inflation has something to do with too much money; if we could get out the message that when we say we're going to control money, we mean we're going to deal with inflation, then we would have a chance of affecting... behavior” (Ibid., 164-167). He hoped that once the Federal Reserve had changed its operating techniques, it “would find it difficult to back off even if our decisions led to painfully high interest rates” (Ibid. 1992, 164-167).

Significantly, Carter himself would refrain from criticizing the Federal Reserve, virtually through to the fall 1980 election. Volcker recalled that “while the president would strongly prefer that we not move in the way we proposed, with all its uncertainties, he was not going to insist on that judgment in an unfamiliar field over the opinion of his newly appointed Federal Reserve chairman” (Ibid. 1992, 169). Responding to a reporter's query regarding the possible dismissal of Volcker during the fall of 1979, Carter responded that it was “not possible to get rid of Mr. Volcker under the American law” and echoed Volcker's rationale for tight money by affirming that “[t]he best way to get interest rates down is to lower inflation.”¹⁸ Carter himself would in fact publicly reinforce the broader attempt at restraining demand, by shifting to pursue a balanced budget in early 1980, when the OMB reported that the current year's budget deficit would be fifty percent higher than had been expected. This led Carter to reopen the budget process itself, cutting spending further while also resisting appeals for a tax cut.

Carter reinforced these shifts in his rhetorical efforts, as he placed an increasing stress on the need for austerity, arguing that the “first and most immediate [means to

¹⁸ Carter did criticize the Federal Reserve late in the 1980 campaign, terming “the strictly monetary approach to the Fed's decision on the discount rate” an “ill-advised” policy (Biven 2002, 245-246).

containing inflation] is fiscal and monetary restraint.”¹⁹ Paralleling Volcker’s invocation of Vietnam, Carter went on to argue that Johnson administration fiscal excesses had driven the 1970s inflation. Carter recalled that the “rate of inflation surged upward...first... in the late 1960’s, when the Vietnam war and the Great Society programs were financed for a number of years without a tax increase.” Carter argued that “excessive demand in the economy, fed by an overly large Federal budget deficit” ultimately undermined monetary stability, lamenting a “tendency for government to stimulate the economy somewhat too freely.” He therefore concluded that “monetary and fiscal policies must apply steady anti-inflationary restraint.”²⁰ Such views would be articulated yet-more-forcefully in Ronald Reagan’s 1981 inaugural claim that “government is not the solution to our problem; government is the problem.”²¹ Taken together, in the context of systemic pressures and diminishing domestic trust in government, pessimism regarding the effectiveness of incomes policies took on the cultural weight of a self-fulfilling prophecy, engendering an enduring recourse to monetary restraint as the primary means to combating inflation and promoting currency stability.

Implications and Conclusions

This analysis has implications for materialist-constructivist debates over the nature of policy

¹⁹ “Economic Report of the President: Annual Message to the Congress,” January 30th, 1980
<<http://www.presidency.ucsb.edu/ws/index.php?pid=32868&st=&st1=>>

²⁰ “Economic Report of the President: Annual Message to the Congress,” January 17th, 1981
<<http://www.presidency.ucsb.edu/ws/index.php?pid=44550&st=&st1=>>

²¹ Ronald Reagan, “Inaugural Address,” January 20, 1981
<www.presidency.ucsb.edu/ws/index.php?pid=43130&st=&st1=>

constraints and the role of crises as mechanisms of change. First, it highlights the role of shared attitudes that can take on “lives of their own” in ways that shape policy possibilities. From this vantage, the late-1970s abandonment of incomes policies reflected not innate deficiencies or material shifts, but rather a trend to steadily diminishing trust in government. The above analysis has specifically suggested that this trend of diminishing trust assumed the force of a self-fulfilling prophecy, undermining the legitimacy of public appeals to private wage-price restraint. From this vantage, if the prevailing skepticism were to dissipate, incomes policies might again be employed – as they were over much of the post-World War II era – to successfully coordinate wage, price and currency expectations. In short, this analysis suggests that what “everybody knows” can take on a life of its own, reshaping policy possibilities over time.

Secondly, this analysis speaks to debates over the interplay of crises and policy change, highlighting the importance of the intersubjective context in not only shaping – but also transforming – policy preferences. Even where ostensibly “major” crises – like the macroeconomic shocks of the 1970s – appear to engender unambiguous shifts in material structures, agents must collectively interpret such events as having some significance before reacting to them. Moreover – as highlighted in this effort – such interpretive struggles are often mediated across mass and elite contexts by key agents – including representatives of a rhetorical presidency and macroeconomic officials like the Chairman of the Federal Reserve – in ways that are not sufficiently captured by approaches which highlight the discourses of elite norm entrepreneurs.²² Writ large, from this vantage, the main constraints on policy autonomy appear rooted less in material constraints than in the intersubjective – mass *and* elite – contexts that

²² For more on mass and elite discourses in the social construction of crises, see Widmaier, Blyth, and Seabrooke, 2007.

shape interpretations of policy changes. In short, only after agents have interpreted crises can they react to them, in ways which can advance or forestall change.

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