Governing the Float: Credibility and the U.S. Dollar

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Abstract

This paper argues that floating exchange rates constitute a mode of governance rather than the absence of one. Drawing on archival transcripts of the U.S. Federal Reserve's Federal Open Market Committee from 1973 to the mid-1990s, it shows how exchange-rate governance persisted following the collapse of Bretton Woods, initially through discretionary interventions justified by a distinction between market "psychology" and economic "fundamentals." As monetary governance was reorganized around credibility and expectations, however, intervention became increasingly incoherent within the Federal Reserve's governing logic. The dollar was progressively redefined from an object of management into a signal through which policy consistency and credibility were assessed. In doing so, the paper extends economic sociological accounts of governing through markets, demonstrating how central bank authority operates through signals and restraint, rather than direct price control.

1. Introduction

Economic sociology has shown that modern central banks govern increasingly through markets, exercising authority by shaping expectations rather than by directly controlling prices (Braun 2015; Wansleben 2018; Walter and Wansleben 2020). Yet this literature has focused overwhelmingly on domestic monetary instruments. This paper extends these insights to the problem of exchange-rate governance under floating regimes. Despite the progressive abandonment of foreign-exchange intervention and associated policy tools, the Federal Reserve has continued to treat movements in the U.S. dollar as consequential policy signals, closely monitoring exchange-rate dynamics and debating their implications for monetary credibility and financial stability. This raises the question of how the retreat from direct price management associated with floating exchange rates can be reconciled with the Federal Reserve's continued treatment of the dollar as a consequential object of governance.

This paper argues that, rather than abandoning exchange-rate governance, the Federal Reserve reorganized it. Through a prolonged process of institutional decoupling and recoupling, the dollar was progressively absorbed into a credibility-based regime of monetary governance, in which exchange-rate outcomes were treated not as objects of direct management, but as signals through which the consistency and credibility of policy were assessed.

This reorganization unfolded over several decades. In the years immediately following the collapse of Bretton Woods in 1973, Federal Reserve officials confronted a fundamental tension: they formally embraced floating exchange rates while remaining deeply concerned with volatility in the dollar. This tension was initially managed through a strategy of decoupling. Officials distinguished between the long-run determinants of the exchange rate and short-run market dynamics, allowing them to affirm market determination in principle while continuing to intervene episodically in response to perceived disorder.

Over time, however, this arrangement became increasingly difficult to sustain. Beginning with the reorientation of U.S. monetary governance under Paul Volcker in 1979, the Federal Reserve progressively reorganized policy around credibility and expectations management. In this context, exchange-rate movements came to be interpreted less as errors requiring correction and more as signals through which the stance and credibility of monetary policy were assessed, alongside broader judgments about U.S. economic stability. The dollar was thus absorbed into a credibility-based regime of monetary governance, in which floating exchange rates were institutionalized as an outcome of domestic policy rather than as an object of indirect management, completing the process of institutional recoupling.

By reconceptualizing floating as a mode of governance rather than the absence of one, this paper extends economic sociological accounts of market governance and central bank authority. It demonstrates that the credibility-based governance regime adopted by the Federal Reserve extends to the exchange rate. As the Federal Reserve pivoted from directly controlling prices to managing expectations, the exchange rate was progressively reconceptualized as a signal through which the regime's efficacy was assessed. The absence of direct management of the exchange rate does not entail the absence of governance, but its reorganization around credibility and restraint. From this perspective, central bank independence rests not only on insulation from political pressure, but on the capacity to refuse particular forms of action while maintaining authority over their consequences.

2. Exchange Rate Governance under Floating: Decoupling and Recoupling

Economic sociology has developed an influential account of modern central banking as governance through expectations. Krippner's (2011) institutional history demonstrates how Federal Reserve officials transformed monetary governance by abandoning direct control of interest rates in favor of policy procedures that allowed markets to infer the stance of monetary policy, thereby reshaping the relationship between state authority and market processes. Subsequent work has generalized this insight into a broader theory of expectations-based governance, drawing on Beckert's (2013) conception of the economy as a system structured by expectations. Within this framework, central banks govern recursively through markets, as policy pronouncements function as signals that shape expectations about future inflation, interest rates, and macroeconomic stability (Braun 2015; Wansleben 2018; Walter and Wansleben 2020).

Credibility is central to this mode of governance: market actors adjust their expectations only insofar as policy signals are perceived as credible. The Federal Reserve's sustained commitment in the early 1980s to tight monetary policy despite severe recessionary pressures is therefore widely understood as a critical moment in the consolidation of credibility-based governance (Krippner 2011; Walter and Wansleben 2020). Yet existing accounts of expectations-based central banking have focused overwhelmingly on domestic monetary variables, leaving the role of exchange rates largely unexamined. This paper extends the sociology of central banking by showing how credibility-based governance came to encompass the exchange rate itself. As the Federal Reserve increasingly governed through expectations, the dollar was redefined from a policy variable in need of direct management into a governed signal through which the consistency and credibility of monetary policy were assessed.

To explain the transformation in U.S. exchange-rate governance, I draw on Meyer and Rowan's (1977) concept of decoupling, which describes how organizations formally adopt institutionally sanctioned practices while allowing day-to-day operations to diverge from those formal commitments. This framework is particularly useful for analyzing exchange-rate governance under floating, where central banks publicly affirm market determination while remaining deeply concerned with the consequences of price movements. In such contexts, externally sanctioned "best practices" function as institutional myths: authoritative narratives that stabilize organizational legitimacy under conditions of uncertainty. Importantly, "myth" does not imply falsity. Rather, it denotes a shared institutional account that structures what forms of action are legitimate, even when organizational practice departs from formal prescriptions.

Decoupling operated through a distinction between market "psychology" and economic "fundamentals." While Federal Reserve officials described the dollar as floating, they maintained that exchange-rate markets could become disorderly, producing price movements that deviated from underlying economic conditions. Under such circumstances, intervention was framed not as a departure from floating but as necessary to sustain the regime itself. Interventions were justified not as attempts to manage the exchange-rate level directly, which would contradict the institutional myth of market determination, but as efforts to stabilize market psychology and restore proper pricing. Decoupling thereby stabilized exchange-rate governance by allowing officials to intervene without challenging the legitimacy of floating as an organizing principle.

Analytically, decoupling highlights the dilemmas confronting policymakers under early floating. While floating exchange rates formally precluded direct management of the exchange-rate level, volatility in currency markets was frequently intolerable in the eyes of Federal Reserve officials. As Meyer and Rowan suggest, decoupling provides a mechanism through which organizations reconcile such tensions, performing adherence to institutionalized expectations while retaining discretion to address operational exigencies. The ambiguity surrounding what constituted a "disorderly market" enabled Federal Reserve officials to exercise professional judgment, authorizing a wide range of governance practices without destabilizing the institutional settlement of floating. Decoupling thus rendered ongoing official involvement compatible with formal non-intervention. By describing governance as decoupled, I do not seek to reclassify the exchange rate regime, but rather highlight how officials reconciled intervention with the institutional logic of floating.

A second analytical benefit of describing exchange-rate governance as decoupled is that it provides a way to explain institutional change over time. Decoupled settlements are stable only so long as they serve an organization's governing needs. As the Federal Reserve's broader strategy of monetary governance transformed, however, the functional utility of decoupling began to erode. Exchange-rate governance subsequently recoupled with the institutional logic of floating, as Federal Reserve officials ceased to treat the exchange-rate level as an object of responsibility, even indirectly. Importantly, recoupling here does not imply a simple return to an original conception of floating. Rather, practices aligned with floating within a transformed credibility-based regime of monetary governance. Whereas existing accounts of recoupling typically emphasize external enforcement, professionalization, or resource dependence as drivers of alignment between formal rules and organizational practice (Hallett 2010; de Bree & Stoopendaal 2022; Jemma 2022), the present case points to a different mechanism. Recoupling was driven by a transformation in the Federal Reserve's governing logic that rendered previously tolerated discretionary practices dysfunctional.

As monetary governance was reoriented around credibility and expectations management, efforts to guide exchange-rate pricing indirectly became increasingly superfluous, and ultimately counterproductive. With monetary authority now centered on shaping expectations across financial markets, the dollar was repositioned as one among a broader set of indicators of market confidence in the Federal Reserve's policy stance. Interventions aimed at stabilizing the discrete domain of "exchange-rate psychology" paled in significance relative to the primary instruments of monetary policy, particularly as expanding capital mobility rendered exchange-market operations comparatively small. Moreover, Federal Reserve officials feared that attempts to influence the exchange-rate level, even indirectly, risked sending conflicting signals regarding policy priorities and institutional credibility. Recoupling thus followed from a transformation in monetary governance that both diluted the utility of the decoupled arrangement and rendered its continuation potentially destabilizing.

This account extends economic sociological analyses of expectations-based governance. Existing work has shown how central banks govern by shaping expectations rather than directly controlling prices. The present case demonstrates that this governing logic reorganized not only domestic monetary instruments but also the exchange rate itself. Crucially, however, expectations-based governance did not operate symmetrically across price domains. Whereas the Federal Reserve retained formal authority and responsibility over the interest rate, governing its effects through market signaling, exchange-rate governance involved a more radical reconfiguration. The dollar was progressively displaced from the domain of policy responsibility and recast as an interpreted market outcome functioning as a signal of policy credibility. Yet this displacement did not imply the withdrawal of authority. As intervention became incompatible with credibility-based signaling, restraint itself emerged as a mechanism of governance. Floating, in this sense, marked not the absence of control, but the reconstitution of authority through credibility and interpretation.

This argument complements the exchange-rate regime literature in international macroeconomics, which distinguishes between de jure regimes, defined by official policy commitments, and de facto regimes, reflecting observed policy practices (Calvo and Reinhart 2002; Reinhart and Rogoff 2004; Levy-Yeyati and Sturzenegger 2005). This distinction closely parallels the decoupling dynamic analyzed here. Just as economists observe divergence between formal regime classifications and policy behavior, a sociological perspective highlights how institutional settlements permit variation in practice without destabilizing legitimacy. The de jure/de facto distinction acknowledges that regimes cannot be inferred solely from formal commitments or policy instruments. More recent classification efforts therefore emphasize policymakers' stated intentions, defining freely floating regimes as those in which authorities refrain from intervention with the explicit aim of managing the exchange rate (Ilzetzki, Reinhart, and Rogoff 2019). The present analysis extends this insight by treating the interpretive frameworks through which policymakers define intervention, disorder, and legitimacy as themselves objects of sociological inquiry. Rather than classifying regimes, this paper employs the mechanisms of decoupling and recoupling to explain how exchange-rate governance was stabilized, contested, and transformed within the institutional boundaries of floating

Viewed through this framework, the historical trajectory of dollar governance can be understood as a transformation in the institutional conditions under which intervention remained intelligible. Under early floating, decoupling stabilized governance by permitting discretionary intervention while preserving the legitimacy of market determination. As monetary governance was reorganized around credibility and expectations management, however, practices once compatible with floating became increasingly incoherent within the emerging governing logic. Recoupling did not reflect external enforcement or ideological conversion, but an endogenous process through which the Federal Reserve reconstituted the exchange rate as a governed signal rather than a managed object. In this settlement, restraint itself became a central mechanism of governance. Floating exchange rates thus emerged not as the withdrawal of monetary authority, but as the institutionalization of a credibility-based regime in which interpretive authority displaced direct price management.

As exchange-rate governance operates through evolving interpretive frameworks rather than solely through observable policy instruments, this paper traces its transformation through the arenas in which such interpretations are articulated. The empirical analysis therefore draws on transcripts of Federal Open Market Committee (FOMC) meetings, where policymakers collectively defined the meaning of exchange-rate movements, and negotiated the boundaries of institutional responsibility. These deliberations provide a uniquely direct window into the governing logics that structured exchange-rate governance, allowing the analysis to capture shifts that would remain invisible in classifications based solely on policy outcomes or intervention frequencies.

3. Data & Methods

To trace the transition from a decoupled to a recoupled governing logic, this paper draws on transcripts of meetings of the Federal Open Market Committee (FOMC) between 1973 and 1996. This period spans the collapse of Bretton Woods, the consolidation of floating exchange rates, and the eventual cessation of routine foreign-exchange intervention, making it well suited for examining shifts in exchange-rate governance over time. I chose the FOMC as the relevant venue because it is the policymaking body within the Federal Reserve responsible for setting monetary policy, and includes members of the Board of Governors, presidents of the regional Federal Reserve Banks, and staff economists who present economic and financial forecasts. Another relevant actor attending FOMC meetings is the Manager for the System Open Market Account (SOMA), who is responsible for managing open market operations, including foreign-exchange interventions. FOMC officials often referred to the SOMA as the 'System' or the 'Desk' when discussing exchange rate policy. During most of the period examined, the FOMC met monthly, before transitioning to roughly eight meetings per year in the mid-1990s.

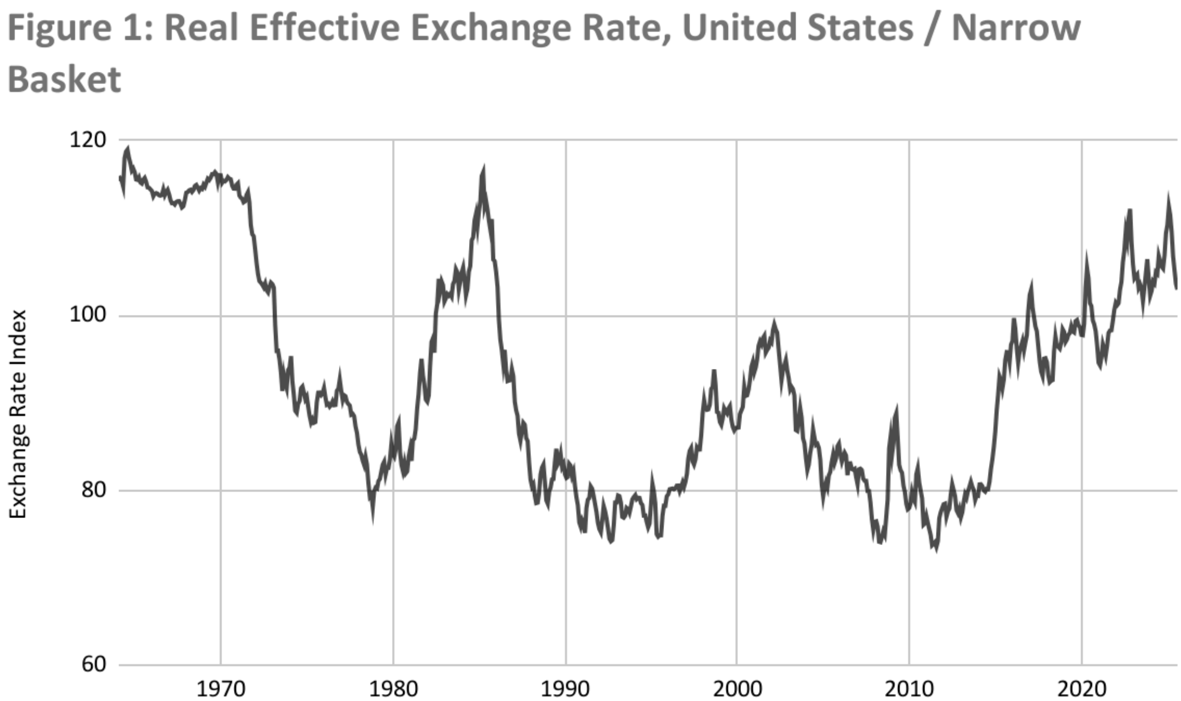
FOMC transcripts provide direct evidence of changes in exchange-rate governance because they record deliberations in which officials explained, justified, and contested policy practices to one another. Exchange-rate governance was most often articulated through presentations by the SOMA manager on conditions in foreign-exchange markets, including justifications for intervention or restraint. These presentations frequently prompted questioning by other FOMC participants, who pressed the SOMA manager to clarify the purpose and limits of intervention; for example, by emphasizing that interventions were intended to influence market psychology rather than to re-peg the exchange rate. Governance was also clarified in moments of uncertainty, such as when officials debated the meaning of 'disorderly markets,' or justified inaction during periods of exchange-rate volatility.

Transcripts were filtered for relevance. Meetings in which exchange-rate governance was not discussed were excluded from the dataset. Following this process, fifty FOMC meetings in which exchange-rate governance featured prominently were retained for analysis. From these transcripts, I extracted passages in which officials raised questions, expressed concerns, or articulated justifications regarding exchange-rate intervention and its relationship to monetary policy. These passages were coded by recurring themes, including distinctions between market 'psychology' and economic 'fundamentals', tensions between intervention and price stability, and debates over the legitimacy of acting on the exchange rate under a floating regime. Coding focused not on policy outcomes, but on how officials defined the purpose and legitimacy of exchange-rate governance, allowing me to trace changes in how the exchange rate was understood as a policy object over time.

While FOMC transcripts capture elite deliberation rather than policy outcomes, they are uniquely suited to analyzing interpretive governance. Because officials were required to justify their actions and inactions to one another, the transcripts reveal how governing logics were articulated, contested, and revised within the organization itself. After coding, key excerpts were selected to anchor the empirical narrative from decoupling to recoupling, often clustered around meetings in which exchange-rate governance was discussed at length.

The empirical narrative is organized into three periods corresponding to distinct configurations of exchange-rate governance. The first, spanning 1973–1979, covers the immediate aftermath of Bretton Woods and documents how Federal Reserve officials carved out a distinction between market psychology and economic fundamentals, clarifying the meaning of ‘disorderly’ markets under a newly floating regime. The second period, from 1979 to 1985, traces the subsumption of exchange-rate governance into a credibility-based monetary regime following the Volcker disinflation, and the consolidation of this settlement during the strong-dollar episode of the mid-1980s. The final section, focusing on 1988–1992, examines the persistence of this governing logic as it was challenged by renewed external pressures for exchange-market intervention.

Throughout the analysis, selected quotations capture how Federal Reserve officials reacted to movements in the dollar and justified policy action or restraint. Figure 1 provides a descriptive reference for these discussions by situating officials’ deliberations in relation to broad movements in the dollar’s value. It is not treated as explanatory evidence, but as contextual background for the interpretive claims traced in the transcripts.



Source: *Bank for International Settlements (BIS), Effective Exchange Rates, WS_EER 1.0,* https://data.bis.org/topics/EER/BIS%2CWS_EER%2C1.0/M.R.N.US, September 4, 2025. *The figure reports the U.S. real effective exchange rate, expressed as an index (2020 = 100). Values above (below) 100 indicate a real appreciation (depreciation) of the U.S. dollar relative to its 2020 level. The series is constructed against a basket of major trading partner currencies.*

4. The Reorganization of Exchange-Rate Governance

4.1 Psychology, fundamentals and market disorder under early floating (1973-1979)

By early 1973, the Federal Reserve found itself operating within a monetary regime that existed in name but not yet in practice. The Smithsonian pegs, established in December 1971 following the initial collapse of Bretton Woods, had themselves unraveled, leaving no stable alternative in their wake. Although the dollar was now formally described as 'floating,' the implications of floating for monetary governance remained deeply uncertain. Exchange rates moved violently, and speculative activity was widely perceived as destabilizing. As Federal Open Market Committee officials struggled to orient themselves within this institutional vacuum, the question was not simply how the dollar would be priced, but how it would be governed.

The depth of this uncertainty is evident in a March 20, 1973 meeting of the FOMC, where the Manager of the SOMA, Charles Coombs, remarked that "the international financial system has broken down so completely that it is difficult to describe even in general terms what is left of the system and how it may be expected to function in the future (FOMC, March 20, 1973: 62)." In the absence of settled rules or clear benchmarks, FOMC officials were forced to improvise a vocabulary through which intervention could be justified without contradicting the emerging commitment to floating exchange rates.

It was in this context that officials began to articulate a distinction that would become foundational to post–Bretton Woods exchange-rate governance: the separation between exchange-rate "fundamentals" and market "psychology." Coombs introduced this distinction in March 1973 while explaining the purpose of a $300 million intervention. He argued that "it was not profitable to think of intervention except as part of a much larger program - was that it could change psychology (FOMC, March 20, 1973: 10)." Intervention, in this framing, was not intended to manage the exchange-rate level directly, but to realign market behavior with underlying economic conditions.

The legitimacy of this distinction, however, was contested. In a July 1973 meeting, President Darryl Francis questioned whether such interventions implied the existence of an implicit exchange-rate target, noting that "it was still not clear to him whether the System would have some specific exchange rate target in view." Coombs responded by reaffirming that the aim was not "to establish any artificial pattern of rates," but to "dissipate the present speculative fever" and guide rates toward levels consistent with "underlying supply and demand relationships," which he maintained would ultimately be set by market forces (FOMC, July 17, 1973: 10).

This exchange exposed a deeper disagreement over epistemic authority. Francis remained skeptical that policymakers could reliably distinguish between legitimate market forces and speculative distortions, suggesting instead that prevailing exchange rates might already reflect the workings of the market. The Chairman of the FOMC, Arthur Burns, intervened to clarify the Committee's position. While conceding that exchange-rate movements could be described as "market forces," Burns argued that prevailing volatility reflected a more fundamental breakdown of confidence. Describing conditions as "chaotic," he asserted that the purpose of intervention was "to restore some order to the market."

Terms such as "psychology," "speculative fever," and "order" versus "disorder" would recur frequently in FOMC deliberations during this period. Far from rhetorical flourishes, these categories functioned as governing distinctions, allowing officials to intervene in foreign-exchange markets while preserving the institutional myth of floating. By defining certain forms of volatility as illegitimate expressions of market behavior, Federal Reserve officials carved out a domain of discretionary action within a regime formally committed to non-intervention.

In the months that followed, developments in exchange markets appeared to confirm for many FOMC officials the validity of the psychology-fundamentals distinction. After a series of interventions totaling $273 million, volatility in foreign-exchange markets subsided. Reviewing this experience in August 1973, Charles Coombs reported that recent operations “have done quite a bit to restore a fairly orderly market,” adding that interventions were most effective when conducted “on a larger scale and in a more forceful and visible manner” in order “to change market psychology for the better (FOMC, August 21, 1973: 14).” In these early assessments, the calming of markets was taken as evidence that intervention, properly framed, could realign psychology with underlying economic conditions without violating the principle of floating.

This interpretation was reiterated later that year, as officials debated whether improving market conditions reflected changes in fundamentals or shifts in expectations. In a November meeting, Governor J. Dewey Daane asked whether relative calm was attributable to improvements in the U.S. trade balance and expectations of further adjustment. Coombs agreed that fundamentals mattered, but emphasized the “demonstrated readiness” of both the U.S. and German central banks to intervene as an additional source of confidence (FOMC, November 16, 1973: 10). Whereas traders had earlier viewed the dollar as vulnerable to sharp declines, he noted, they now believed that “any temporary declines would not be large.” The distinction between psychology and fundamentals thus became a routine explanatory device through which officials interpreted market behavior.

At the same time, these episodes exposed a persistent tension concerning epistemic authority. When the dollar again came under pressure in early 1975, the new SOMA manager, Scott Pardee, attributed the decline primarily to “psychological” factors and reported that coordinated intervention with the German central bank had helped stabilize markets. Governor Jeffrey Bucher, however, questioned whether the scale of intervention suggested an effort not merely to counter disorder, but to “resist a downward trend in the value of the dollar on the assumption that the System knew better than the market what the dollar’s value ought to be

(FOMC, February 19, 1975: 21)." As in earlier debates, the legitimacy of intervention hinged on whether officials could plausibly distinguish exaggerated expectations from genuine market judgment.

In response, Pardee reaffirmed the governing logic that had emerged since 1973. The immediate problem, he argued, "had less to do with fundamentals than with the state of psychology," which had become distorted by exaggerated expectations of declining interest rates. "The fundamentals," he maintained, "were such that the dollar should be strengthening," and it was through shifts in market psychology that alignment would ultimately be restored. Governor Henry Wallich further clarified that intervention functioned as a signal rather than a tool for managing a specific exchange-rate level. While opposing efforts to "push up" the dollar, he observed that markets had suspected the United States of indifference; by demonstrating concern, officials had helped restore order.

Taken together, these episodes show how the psychology-fundamentals distinction was consolidated as a governing logic during the early years of floating. By framing intervention as a means of influencing expectations rather than setting prices, Federal Reserve officials stabilized exchange-rate governance under conditions of uncertainty. At the same time, the reliance on discretionary judgments about market psychology left unresolved questions about epistemic authority, questions that would become increasingly salient as monetary governance was reorganized around credibility in the following decade.

The consolidation of the psychology-fundamentals distinction relied not only on interpretive categories, but also on an institutional vocabulary that authorized intervention under a formally floating regime. In the early years of floating, Federal Reserve officials employed a range of euphemisms to distinguish between legitimate and illegitimate market forces. Over time, the language of “orderly” and “disorderly” markets came to dominate. When market psychology was understood to diverge from economic fundamentals, markets were described as “disorderly,” rendering intervention legitimate as an effort to restore order.

This language carried institutional weight because it appeared in the Federal Reserve’s Authorization for Foreign Currency Operations, which delegated authority to intervene in order to “aid in avoiding disorderly conditions in exchange markets (FOMC, March 16, 1976: 100).” Whether markets were judged to be disorderly thus became a conceptual lynchpin of exchange-rate governance, linking discretionary intervention to a formally sanctioned mandate.

At the same time, FOMC officials recognized that the concept was inherently vague. In July 1977, Governor George Mitchell questioned whether recent interventions were consistent with the authorization. Responding, Alan Holmes, then Manager of the SOMA, emphasized that the Desk’s actions were intended to maintain “orderly market conditions rather than to support the dollar at any particular rate (FOMC, July 19, 1977: 2).” Chairman Arthur Burns followed by noting that the notion of an orderly market was imprecise and that the Foreign Currency Directive could be interpreted in multiple ways. Holmes continued to argue for more aggressive intervention, claiming that traders were pushing the dollar down in ways that could not be justified by the fundamentals. Burns responded by rejecting this diagnosis outright. Pointing to the size of the U.S. trade and current-account deficits, as well as rising inflation, he argued that markets were behaving “quite rationally.” If volatility reflected fundamentals rather than psychological distortion, he concluded, the implications for intervention were “not entirely clear.”

Burns’s intervention marked an early articulation of a view that would become increasingly influential in subsequent years: that volatile exchange-rate movements could constitute a rational market response to underlying economic conditions, and therefore lay outside the legitimate scope of exchange-rate governance. By collapsing “disorder” back into fundamentals, this interpretation undermined the discretionary space that had sustained decoupled governance, and foreshadowed the later redefinition of exchange-rate movements as signals rather than objects of correction.

The ambiguity surrounding “disorderly markets” came to a head in 1978, a year marked by a perilous decline in the dollar. As pressure mounted to justify increasingly large interventions, the governing logic of early floating began to visibly unravel. In February, Scott Pardee was again asked to clarify the Desk’s policy and, at President David Eastburn’s prompting, to provide a precise definition of what constituted a “disorderly” market.

Pardee responded by reiterating the now-familiar distinction between psychology and fundamentals. After assuring the Committee that the System was not pegging the dollar, he argued that markets sometimes “overdo it,” moving beyond rates that could be justified by “a broad element of judgment in terms of economic fundamentals, market sentiment, and policy considerations (FOMC, January 17, 1978: 12).” Such rates, he concluded, were “exaggerated…they’re wrong.” Rather than resolving the issue, this explanation intensified skepticism among Committee members and prompted a prolonged debate over whether markets could meaningfully be classified as disorderly at all.

The discussion ultimately ended with a blunt intervention by Chairman Arthur Burns. “We will get absolutely nowhere,” Burns warned, “because nobody knows what disorder means, including those who operate the Desk.” Rejecting the category outright, he added that “I don’t like the language of disorder; there is an element of disingenuousness about it - not intended, but I believe it’s there.” These exchanges reveal the limits of the decoupled governing logic that had sustained early floating. By the late 1970s, the discretionary space created by appeals to market psychology and disorder had become increasingly difficult to defend, leaving exchange-rate governance vulnerable to redefinition under a different organizing principle.

4.2 Credibility-Based Governance and the Strong Dollar Episode (1979–1985)

Internal dissension within the FOMC over the meaning of disorderly markets, and persistent suspicion that the Desk was, in practice, pegging the dollar, continued throughout the 1970s. This decoupled governing logic, however, became increasingly untenable as inflation accelerated and confidence in U.S. monetary policy eroded. It was not until the appointment of Paul Volcker as Chairman of the Federal Reserve in 1979 that the prevailing approach to exchange-rate governance decisively collapsed.

Soon after assuming the chairmanship, Volcker announced a new mode of monetary governance aimed at breaking inflationary expectations. Rather than smoothing interest rates, the Federal Reserve altered its operating procedures to allow rates to fluctuate sharply, signaling its willingness to tolerate recession in pursuit of price stability. This was not merely a change in policy technique, but a transformation in governing logic. Monetary governance was reoriented around credibility: market expectations were to be anchored through the demonstrated resolve of the central bank, rather than through discretionary management of specific markets. In this context, exchange-rate and financial-market movements were no longer treated as domains requiring separate psychological intervention, but as signals through which the credibility of monetary policy itself was assessed.

This shift was made explicit in September 1979. Following another prolonged discussion over whether exchange markets were sufficiently "disorderly" to justify intervention, Volcker rejected the premise of the debate altogether. "I don't think we are talking about a program here just to support the dollar," he argued. "The dollar is part of the total situation…this is really all one ball of wax at this point. The psychology in the foreign markets is the same as the psychology at home (FOMC, November 6, 1979: 15)." Exchange-rate movements were thus subsumed within a broader conception of market psychology centered on inflation expectations. Rather than constituting a distinct domain of governance, the dollar became one manifestation of the Federal Reserve's overall credibility.

Subsequent discussions within the FOMC illustrate how this governing logic was operationalized. In May 1980, President Lawrence Roos warned that any perceived retreat from monetary restraint would trigger a collapse in the dollar. Public concern about the exchange rate, he argued, would be read by markets as evidence that "the Fed is retreating to its old practice of concentrating on the stabilization of interest rates," with "catastrophic" consequences for the dollar's value (FOMC, May 20, 1980: 23). Volatility in exchange markets was thus conceptualized not as a problem to be managed directly, but as downstream of the Federal Reserve's credibility.

This logic was reiterated later that year by Vice Chairman Anthony Solomon, who interpreted the dollar's sensitivity to interest-rate movements as evidence of restored confidence. Had market participants remained pessimistic about U.S. monetary policy, he suggested, the dollar would have faced "consistent pressure." Instead, responsiveness to interest rates reflected a "neutral view" of the dollar - an indication that exchange-rate movements were functioning as signals of monetary credibility rather than as objects of discretionary intervention (FOMC, August 12, 1980: 4). By the early 1980s, exchange-rate governance was being reorganized around a credibility-based regime in which the dollar was governed through the consolidation of expectations, rather than through psychological management or market-by-market discretion.

At the same time, the transition in governing logic was not instantaneous, and foreign-exchange intervention remained a potential, if increasingly subordinate, policy tool. In a May 1980 meeting, Paul Volcker acknowledged the risks posed by conditions in exchange markets, but expressed deep skepticism that intervention could address them. "I don't have any confidence that we can deal with them through intervention anyway," he remarked, adding that while he had "nothing against intervention per se," its effects were necessarily limited. In certain circumstances, intervention might help "maintain a feeling of stability in exchange markets," but it was "not going to take care of the situation fully if it really develops in an adverse way (FOMC, May 20, 1980: 28)."

For Volcker, the decisive variable shaping market psychology was inflation. "It's not a risk," he emphasized. "It's here." Inflation, rather than exchange-rate movements themselves, sat at the top of the causal hierarchy governing expectations, recession dynamics, and confidence in monetary policy. Volcker's intervention thus captured the FOMC caught between two approaches to exchange-rate governance: while intervention was not ruled out entirely, it was relegated to a secondary, palliative role within a governing framework increasingly centered on credibility and inflation control.

The Federal Reserve's monetary targeting experiment drove interest rates sharply higher in the early 1980s, contributing to a dramatic appreciation of the dollar. High interest rates, combined with domestic financial deregulation, attracted large capital inflows, pushed up the exchange rate, and deepened the U.S. current account deficit. By late 1984, this dynamic had reached a critical point. In a December meeting, President Robert Forrestal described the trade balance as "a very, very distressing feature of the economy," a sentiment echoed by numerous

FOMC participants. Yet the Committee repeatedly concluded that there was little it could, or should, do in response.

Forrestal articulated the dilemma directly. “If we ease policy to bring the dollar down,” he asked, “are we going to reignite inflationary expectations, increase interest rates again, and then bring the dollar back to where it was?” Any attempt to act on the exchange rate risked undermining the credibility of monetary policy, setting off a self-defeating cycle in which inflation expectations rose, interest rates followed, and the dollar ultimately strengthened again. President Roger Guffey echoed this logic, warning that targeting the dollar directly would likely “backfire” and leave the Committee facing an even more serious problem (FOMC, December 18, 1984: 46).

As these discussions unfolded, FOMC officials increasingly framed the strong dollar and widening current account deficit not as problems of monetary governance, but as reflections of broader economic fundamentals beyond the Committee’s remit. Governor Lyle Gramley argued that while there might be ways to bring the exchange rate down, “the policy lever is not in our hands. It’s in the hands of those who set fiscal policy.” Guffey reinforced this boundary, stating that monetary policy could support domestic economic activity, but that responsibility for addressing external imbalances lay with elected officials. President John Balles concurred, pointing to persistent federal budget deficits as constraints that limited the Federal Reserve’s capacity to act on the exchange rate.

Chairman Paul Volcker closed the discussion by explicitly reaffirming the new governing hierarchy. Acknowledging that the United States faced serious international imbalances, “much of it of our own making,” he nevertheless expressed resignation to the persistence of a large current account deficit in the near term. More importantly, he cautioned against even casually framing a lower dollar as an objective of policy. Doing so, he warned, risked eroding confidence in the Federal Reserve's commitment to price stability. "If we have a lack of confidence in the dollar," Volcker concluded, "we're going to have a real picnic in maintaining a decent level of interest rates or a degree of confidence in the inflation outlook." In this formulation, exchange-rate outcomes were no longer targets of governance, but consequences of credibility, reinforcing the recoupled logic through which restraint, rather than intervention, defined effective exchange-rate governance.

The FOMC's decision not to act during the strong dollar episode marked a decisive consolidation of the new governing logic. Despite deep and widely acknowledged imbalances, officials did not attempt to characterize the dollar's appreciation as a symptom of market "disorder." Instead, the prevailing view was that while the exchange-rate level was undesirable, it reflected underlying fundamentals and therefore did not fall within the Federal Reserve's responsibility to correct. Any effort to use monetary policy to address the imbalance, officials argued, would undermine the credibility of the anti-inflationary regime, raising inflation expectations, pushing interest rates upward, and ultimately strengthening the dollar once again.

Volcker's insistence that FOMC officials resist even casual discussion of bringing the dollar down crystallized this redefinition of exchange-rate governance. By explicitly severing the link between undesirable exchange-rate outcomes and policy responsibility, the Committee abandoned the earlier discretionary logic that had justified intervention under floating. Exchange-rate restraint was no longer a failure to govern, but the very means through which credibility-based governance was enacted.

4.3 Defending Credibility under External Pressure (1988–1992)

The strong dollar was ultimately addressed through overtly political means. In 1985, the United States, West Germany, and Japan signed the Plaza Accord, a coordinated agreement aimed at depreciating the dollar. This was followed by the Louvre Accord in 1987, which sought to stabilize the dollar after its subsequent decline. These agreements introduced a renewed external impetus for routine exchange-market intervention, driven primarily by the U.S. Treasury and foreign finance ministries. For the Federal Reserve, this external pressure posed a direct challenge to the newly consolidated credibility-based governing logic, forcing officials to clarify the relationship between intervention, political coordination, and price stability.

Rather than reopening the question of exchange-rate management, renewed pressure to intervene sharpened the tension between intervention and the Federal Reserve's commitment to credibility. Following a series of interventions in November 1988 amid a falling dollar, President Lee Hoskins articulated the concern succinctly. "We have been in on both sides of the market," he warned, "which gives an impression that we know what the right exchange rate is." Such actions, he argued, risked creating expectations that the Federal Reserve was attempting to stabilize the dollar through politically-timed intervention, particularly around the election, thereby inviting a destabilizing reversal once those expectations were disappointed (FOMC, November 1, 1988: 14).

Hoskins went on to identify a deeper danger: continued intervention threatened to undermine the interpretability of monetary policy itself. "By doing this," he cautioned, "I think we continue to confuse the public as to what our policy is all about and divert attention from our long-term objective of stable prices." In this view, intervention no longer merely failed to solve exchange-rate problems; it actively endangered the credibility-based regime by blurring the signal through which monetary policy operated. Exchange-rate governance had become inseparable from expectations management, and interventions that suggested an exchange-rate target risked dulling the very sensitivity of market expectations that the Federal Reserve had spent the previous decade cultivating.

By the late 1980s, the priority of price stability had become firmly entrenched within the FOMC's governing logic. Even officials who expressed concern about the exchange rate or the current account deficit framed those concerns as secondary to, and derivative of, the pursuit of credibility. A revealing exchange from an October 1989 meeting between Vice Chairman Gerald Corrigan and Governor Manuel Johnson illustrates how this recoupled logic structured internal disagreement (FOMC, October 3, 1989: 15):

> VICE CHAIRMAN CORRIGAN**.** I worry about large current account deficits. I certainly don't view them as a goal, as I'm sure you know, Manley.
>
> MR. JOHNSON**.** Sure, but—
>
> VICE CHAIRMAN CORRIGAN**.** The question—if I can just finish—is whether the presence of current account deficits in excess of $100 billion in perpetuity are compatible with an orderly and relatively painless ability to reach that goal of price stability.
>
> MR. JOHNSON**.** And all I'm saying, Jerry, is that I don't know; I don't think anybody knows. It's a debatable issue. But to try and say beforehand that the dollar has to be at some level that some committee decides—
>
> VICE CHAIRMAN CORRIGAN**.** That's a different question.

MR. JOHNSON**.** But it's not; it's the same.

VICE CHAIRMAN CORRIGAN**.** It's not.

This exchange is revealing on two fronts. First, although Corrigan clearly regarded the current account deficit as problematic, he did not invoke the earlier logic of exchange-rate governance that treated such imbalances as evidence of market disorder requiring correction. Instead, the deficit mattered insofar as it threatened the Federal Reserve's capacity to achieve its overriding objective: price stability. Exchange-rate outcomes were no longer policy problems in their own right, but variables that could complicate, or facilitate, the maintenance of credibility.

Second, Johnson's response revived a familiar concern about epistemic authority, questioning whether a committee could legitimately declare market outcomes to be wrong. Corrigan's insistence that this was "a different question" clarified the transformation in governance. He was not advocating for overriding markets or targeting a particular exchange-rate level, as Johnson assumed he was. Rather, he was reframing the issue entirely: the legitimacy of monetary policy no longer hinged on judging the correctness of market prices, but on sustaining a governing framework in which credibility and price stability took precedence. Even officials more sympathetic to intervention thus articulated their positions within the new credibility-based regime, underscoring the consolidation of recoupling rather than its fragility.

In March 1990, Governor Wayne Angell declared that the FOMC had reached a consensus regarding the dollar. "I'm happy," he remarked, "because the Federal Reserve is now…at a consensus position regarding the dollar (FOMC, March 27, 1990: 59)." Exchange-rate depreciation, he emphasized, would no longer be treated as a policy instrument for resolving trade imbalances, as doing so conflicted with the Federal Reserve's commitment to price stability. Where FOMC officials had tentatively articulated this position during the strong dollar episode of the mid-1980s, Angell now declared it confidently as settled institutional doctrine.

The persistence of occasional intervention after this point did not signal a reversal of this governing logic, but rather its narrowing to exceptional circumstances. In August 1992, amid speculative pressure on European financial systems, the Desk again intervened; an action that surprised and unsettled several FOMC participants. President Richard Syron expressed concern that the intervention risked damaging the Federal Reserve's credibility more broadly. Chairman Alan Greenspan, however, justified the action not in terms of correcting exchange-rate misalignment, but as a means of preventing systemic destabilization. Absent intervention, he warned, a sharply weaker dollar risked "spillover effects" that could "crack the structure of the underlying base of the market (FOMC, August 18, 1992: 7)."

Crucially, Greenspan's defense of intervention redefined its purpose. Intervention was no longer a tool for managing the exchange rate or correcting disorderly pricing, but a temporary measure to preserve credibility and prevent self-reinforcing financial spirals under extraordinary conditions. As Angell clarified in the same discussion, the concern was not whether markets were currently disorderly, but whether they might become so. In this formulation, intervention survived not as exchange-rate governance, but as a residual instrument of systemic stabilization; consistent with, rather than opposed to, the credibility-based regime.

By the early 1990s, a credibility-based model of exchange-rate governance had been firmly consolidated within the FOMC. Yet this internal consensus was not immediately reflected in policy practice, largely due to continued external pressure from the U.S. Treasury to use intervention as a routine tool for managing the exchange rate. The persistence of intervention thus reflected not lingering disagreement within the Federal Reserve, but unresolved tensions over institutional authority.

As Chairman, Alan Greenspan undertook a sustained political effort to defend the Federal Reserve's governing logic and preserve its influence over exchange-rate decisions. In a March 1990 meeting, he cautioned that the FOMC could not reflexively deny the U.S. Treasury's pressure to intervene in exchange markets, as it would risk creating a political fissure between it and the Federal Reserve, which would subsequently cause the FOMC to "lose completely all of our capability of influencing decisions that could affect our monetary policies (FOMC, March 27, 1990: 49)." Despite strong sentiment within the FOMC that it should no longer seek to manage the exchange rate level through intervening in exchange markets, Greenspan embarked on a calculated political effort to maintain influence over exchange rate policy by assenting to the demands of the Treasury, while over time convincing its leadership that such policy had to come to an end.

By the mid-1990s, this effort had succeeded. In August 1995, Greenspan declared that "this is the end of the series," noting that resistance to further intervention now came from within the Treasury itself rather than from the FOMC (FOMC, August 22, 1995: 3). This shift coincided with the appointment of Robert Rubin as Secretary of the Treasury and the articulation of the administration's "strong dollar" policy, which explicitly rejected routine intervention to resist market-driven appreciation. What had long been consolidated within the Federal Reserve was now reflected in inter-institutional practice: exchange-rate governance under floating was stabilized not only through interpretive restraint, but through the political alignment of monetary and fiscal authorities.

5. Conclusion

This paper has shown that exchange-rate governance in the United States was not abandoned with the collapse of Bretton Woods, but reorganized. In the years following the end of the dollar peg in 1973, the exchange rate remained an object of Federal Reserve governance, albeit indirectly, through efforts to stabilize market psychology and counter perceived disorder. Over the course of the 1980s, this governing logic was absorbed into a broader credibility-based regime of monetary governance. Exchange-rate movements were no longer treated as a distinct domain requiring discretionary intervention, but as outcomes reflecting the stance and credibility of monetary policy itself. In this settlement, the exchange rate was not merely permitted to reflect the fundamentals of domestic monetary governance, but increasingly understood as a signal of the regime's coherence and efficacy.

The durability of this reorganization is evident in developments in the mid-1990s. In 1995, Treasury Secretary Robert Rubin declared a "strong dollar" policy, which explicitly rejected routine exchange-market intervention to resist dollar appreciation. Rather than marking a new departure, this stance codified a governing logic that had already been consolidated within the Federal Reserve. Recoupling not only stabilized exchange-rate governance, but narrowed the range of legitimate claims that external actors could make on the central bank with respect to the dollar. Persistent current-account deficits and a strong dollar were no longer interpreted as symptoms of disorder requiring correction, but as compatible with, if not indicative of, a credible monetary regime oriented toward price stability and market confidence (DeLong & Eichengreen 2001).

By the early 1990s, the exchange rate had been fully absorbed into a credibility-based mode of governance, functioning less as an object of policy intervention than as a signal through which the success of that regime was assessed. This reinterpretation reflected not the withdrawal of exchange-rate governance, but its reorganization. A strong dollar and a persistent current-account deficit were no longer treated as indicators of disorder requiring correction, but as evidence that a regime of credibility-based monetary governance was functioning as intended.

While this paper does not claim that floating exchange rates operate identically beyond the historical period examined, it does show how the dissolution of the equation between floating and non-governance reshaped the interpretive landscape of monetary policy. By reclassifying external imbalance from a problem in need of correction to a market signal open to interpretation, credibility-based exchange-rate governance created conceptual room for policymakers to tolerate, and normalize, a persistent current-account deficit. This argument does not speak to the causes of that deficit. It instead demonstrates how a transformation in exchange-rate governance altered the terms under which such imbalances were understood and acted upon.

This interpretation also clarifies the distinctive status of the dollar within expectations-based governance. Whereas the Federal Reserve retained formal responsibility for the interest rate while governing its effects through market signaling, exchange-rate governance involved a more radical institutional displacement. The dollar was progressively stabilized as a market-priced object. Crucially, this outcome did not reflect the withdrawal of governance, but its reorganization. By redefining the exchange rate as a signal of policy credibility rather than an object of management, Federal Reserve officials rendered market determination both intelligible and authoritative. The dollar’s emergence as a market object was therefore not the negation of governance, but one of its central institutional accomplishments.

Conceptualizing floating as a mode of governance illuminates a structural tension at the heart of contemporary central bank independence. Under a credibility-based regime, the Federal Reserve's authority rests on refusing to manage the level of the dollar while retaining interpretive authority over exchange-rate movements as signals of monetary policy credibility. This dynamic echoes recent economic sociological accounts that conceptualize central bank independence as an ongoing process of boundary work, through which central banks simultaneously engage markets while stabilizing distinctions between technocratic authority and political decision-making (Coombs & Thiemann 2022; Mudge & Vauchez 2022). Yet the exchange rate responds not only to monetary governance but to broader judgments about the American economy and political order. As a result, the very settlement that stabilizes central bank independence also exposes it to contestation. Pressures on monetary authority may arise not from failures of monetary policy itself, but from the widening gap between the scope of central bank authority and the range of forces to which its key signals remain responsive.

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