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A First Ever Default?
Closing the Gold Window, Forty Years On

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During the recent “Debt Ceiling” debacle, many warned that the failure to lift the debt ceiling would lead to a “first ever” US default and to numerous financial catastrophes, including the demise of the U.S. dollar as the world’s reserve currency.

“First Ever Default?” Think again.

Forty years ago this month, on August 15, 1971, President Nixon “closed the gold window”, refusing to let foreign central banks redeem their dollars for gold, facilitating the devaluation of the U.S. dollar which had been fixed relative to gold for almost thirty years. While not strictly a default on a US debt obligation, by closing the gold window the US government abrogated a financial commitment it had made to the rest of the world at the Bretton Woods Conference in 1944 that set up the post-war monetary system. At Bretton Woods, the United States had promised to redeem any and all U.S. dollars held by foreigners – later limited to just foreign central banks — for $35 dollars an ounce. This promise explains why the Bretton Woods monetary system was called a “gold exchange standard” and why many believed the US dollar to be “as good as gold”. When Nixon refused to let foreign central banks turn in their dollars for gold, and encouraged the devaluation of the dollar which reduced the value of foreign central bank holdings of dollars, the Nixon administration effectively “defaulted” on the United States’ long-standing obligations ending once and for all the Bretton Woods System. (See the useful history by Benjamin Cohen and Fred Block’s masterful history of Bretton Woods, The International Economic Disorder published University of California, Berkley Press.)

The move by Nixon was designed to restore US competitiveness that had been harmed by the reconstruction of Europe and Japan in the decades following the Second World War, and to improve his re-election chances by increasing employment, profits and exports. By the cunning of history, though, while the Nixon “default” was designed to restart the American manufacturing machine, instead it set into motion the forces that would lead to the dominance of finance, the hollowing out of American manufacturing, the massive destruction of decent employment — and eventually to the Crash of 2008.

The dominance of finance resulted from the dramatic political and economic changes engendered by, as Naomi Klein puts it, the rise of disaster capitalism, which took a very specific financial form. The oil “shocks” and stagflation of the 1970’s brought
about the rise of Volckerism, Thatcherism and Reaganism, leading to the policies of sky high interest rates, which undermined the New Deal structures of finance. The extraordinarily high and unstable interest rates created enormous need for new hedging instruments and opportunities for new speculative financial practices. They also imposed enormous losses on financial institutions and financial elites. But the rentiers and financiers did not just sit there and take it: they fought back (see Gerald Epstein and Arjun Jayadev in Financialization and the World Economy) and pushed for financial deregulation to let them compete in the new environment. One financial crisis led to another, from the third world debt crisis to Long Term Capital Management. After each crisis, finance pushed for more bail-outs and more financial de-regulation and won.

All this led to the acceptance of the de-regulation of finance and the push for international capital mobility by banks and multinational corporations while breaking the power of unions. (See Joel Rogers and Thomas Ferguson, Right Turn and Ilene Grabel’s work on capital controls.) More acceptance of capital mobility led eventually to the off-shoring of manufacturing and, with manufacturing decimated, to the dominance of financial activity and profits back home in the U.S. and UK. Clinton and the Democrats cashed in by becoming the party of financial de-regulation both in the U.S. and abroad. (See Robert Pollin’s The Contours of Descent) The financial markets exploded domestically and internationally. We now know where this led in 2007 – 2008.

Many of us thought that the Nixon default of August 15, 1971 and the decline of the U.S. as a manufacturing and trading nation would lead to the demise of the international role of the dollar. But we didn’t anticipate that the explosion of dollar based international finance and the domination by U.S. led global finance would keep the demand for dollar dominated transactions and assets so high. We also didn’t anticipate that Nixon’s visit to China, together with this dollar based financialization would create a co-dependency between Chinese export-led growth, with the help of U.S. multinational corporations, that would maintain the massive demand for dollar assets even as it further hollowed out working class jobs and incomes in the U.S. Almost thirty years ago I asked if the world economy could thrive with a declining currency at its base (see “Triple Debt Crisis”, World Policy Journal). We now know that the answer is no: In the end, the Nixon “default” did not destroy the international role of the dollar. The rise of American financiers and their counter-parts abroad saved the US dollar – but only by starving the US economy of good jobs and by almost destroying the global financial system.

Forty years ago today Nixon “defaulted” and “liberated” the dollar from gold in a wrong-headed, nationalistic and failed attempt to restore American prosperity. Today we need to join forces with others at home and abroad to liberate our political systems from the financial forces unleashed by that move, and turn back those pushing for more and more austerity – social defaults on pensions, medical care and obligations to our youth in the service of lining the pockets of the rich and powerful. Instead, we must push for reaffirming these social commitments and, if necessary, “adjust” the bottom lines of the elites who have been saved from default by the taxpayers’ largess.