THE RISE AND FALL OF BRETTON WOODS

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Introduction

Fifty years ago this week, on August 15th,1971, U.S. President Richard Nixon took to the national airwaves to make a stunning announcement:

> *"I have directed Secretary Connally to suspend temporarily the convertibility of the dollar into gold or other reserve assets, except in amounts and conditions determined to be in the interest of monetary stability and in the best interests of the United States."*

With those few words, Nixon proclaimed the end of the Bretton Woods system of fixed international currency exchange, in which the U.S. dollar had been backed by gold at the unmovable rate of $35 per ounce, while all other currencies were pegged in turn to the dollar. The announcement was unexpected. Nixon had given U.S. allies only a few hours of notice that the "gold window" would soon close. His administration had earlier pledged, as those of Johnson and Kennedy previously did, that the dollar was "as good as gold." In the same televised address, Nixon also stated his intention to impose wage and price controls in the U.S—an unprecedented decision in the postwar era— and announced initial plans, later rescinded, for a tariff to protect the American market from foreign imports.

As remarkable as it was, Nixon's speech entailed far more than a series of financial maneuvers. The scrapping of the Bretton Woods system, in effect, declared to the world that the United States, the guarantor of the postwar order and "the Free World," could no longer play its previous, omnipotent role. "The Nixon shock," as it was called, spelled the end of a set of social and economic relations that had structured the entire post-World War II historical epoch.

In hindsight, the Bretton Woods system may appear to have been somewhat fleeting. It lasted little more than a quarter of a century, from 1944 until 1971, and gave way to a much longer period – a full half-century – defined by freely floating fiat currencies and a host of attendant policies associated with financialization and globalization—policies which have underwritten a very different set of social and economic relations.

Yet despite its short duration, the Bretton Woods system casts a long shadow on the present. It is not possible to understand the present global crisis without understanding its relationship to the rise and fall of Bretton Woods. This piece therefore considers: (i) the emergence of Bretton Woods out of the chaos of the preceding period and the post-WWII order that it undergirded; (ii) the erosion and collapse of that order in the late

1960s and early 1970s; (iii) its replacement by the deflationary epoch of globalization and financialization that followed; and (iv) the unwinding of that latter system up to the present.

Part I

1. In July 1944, with World War II still raging, representatives of 44 Allied countries gathered at the United Nations Monetary and Financial Conference, in the New Hampshire town of Bretton Woods, to create a global system of currency exchange that, it was hoped, would avert the descent into trade war, autarky, and military conflict that had characterized the previous three decades.

2. It was practically an article of faith among those tasked with constructing the postwar order that economic depression, fascism, socialist revolution, and world war had all been a byproduct of the dysfunction of the global financial system. It appeared to them that this dysfunction interfered with the "natural" market exchange between producers and consumers, creating malignities such as mass unemployment and depressed consumer demand. "Who could have thought," Churchill asked in 1933, the trough of the Great Depression, "that it would be easier to produce by toil and skill all the most necessary or desirable commodities than it is to find consumers for them?"

   The conditions giving rise to the paradox described by Churchill could be traced back to World War I, which had resulted in socialist revolution in Russia, the industrial dominance of the United States, massive war reparations imposed on Germany, and a resulting "cycle of debt" among Germany, the U.S., France and Britain. Britain's desperate attempts to maintain the pound in the 1920s forced it to deflate its economy and control its colonial trade through the Sterling Bloc, while massive U.S. industrial capacity, in the heyday of Fordism, far outstripped U.S. access to markets, which the old colonial powers still guarded. These developments induced a turn to financial speculation that led to the Great Crash of 1929. In response, the major industrial powers adopted a series of "beggar thy neighbor" policies including competing currency devaluations and the erection of tariff walls, including the catastrophic Smoot-Hawley tariff law of 1930 in the U.S. The wheels of international trade ground to a halt, propelling forward the rise of demagogues such as Hitler.

   So the thinking went. The conclusion seemed obvious. What peace and stability required was an unencumbered movement of goods—preventing the emergence of rival currency and trading blocs, competitive devaluations and tariffs—but not free movement for monetary speculation. The system of payment had to be stable and predictable. The role of finance was therefore defined largely in a negative and utilitarian way. It would be the handmaiden of economic and social development. "In my view," the chief British negotiator at Bretton Woods, John Maynard Keynes stated, "the whole management of the domestic economy depends upon being free to have the appropriate rate of interest without reference to the rates prevailing elsewhere in the world. Capital control is a corollary to this." Or, as U.S. Treasury Secretary Henry Morgenthau told the Bretton Woods conference, the aim should be to "drive the usurious moneylenders from the temple of international finance."

3. The Bretton Woods Agreement was the result. The United States pegged the dollar to $35 per ounce of gold. The American currency was "as good as gold" at this unalterable rate. In turn, the other signatories pegged their currencies to the dollar at a fixed rate, alterable within a "band" of only 1%, plus or minus, a permissible deviation in the event of current accounts trade disequilibrium. The currency peg was to be maintained primarily through the purchase and sale of dollars as a means of adjusting other currencies. Only in cases of economic emergency could currencies be altered significantly outside of the 1% band. In such cases, the International Monetary Fund (IMF) would oversee and fund temporary adjustments. In addition to creating the IMF, the Bretton Woods agreement established the International Bank for Reconstruction and Development (IBRD), the cornerstone of the future World Bank.

4. The Bretton Woods system is regarded as the only sustained attempt in the history of capitalism to create a cooperatively managed system of international currency exchange. If so, it must be regarded as a highly contingent cooperation, as the entire system, from inception to demise, was dominated by the U.S.

   Of the 44 nations that sent delegations to the Bretton Woods conference, the United Kingdom was the only foreign country to exercise an influence–albeit marginal– over the U.S.-led proceedings. Keynes was tasked with maintaining a substantial position for London in global affairs, which would best be achieved if the dollar was not made the *de facto* reserve currency, as the pound had once been. Keynes called for the formation of a single international currency, the "bancor", a suggestion the head of the American delegation, Harry Dexter White, brushed aside together with most of the British plan. The dollar would prevail. Moreover, votes and influence over the IMF would be determined by the relative size of the contributing economy, which effectively granted the U.S. veto power over the structures of world finance.

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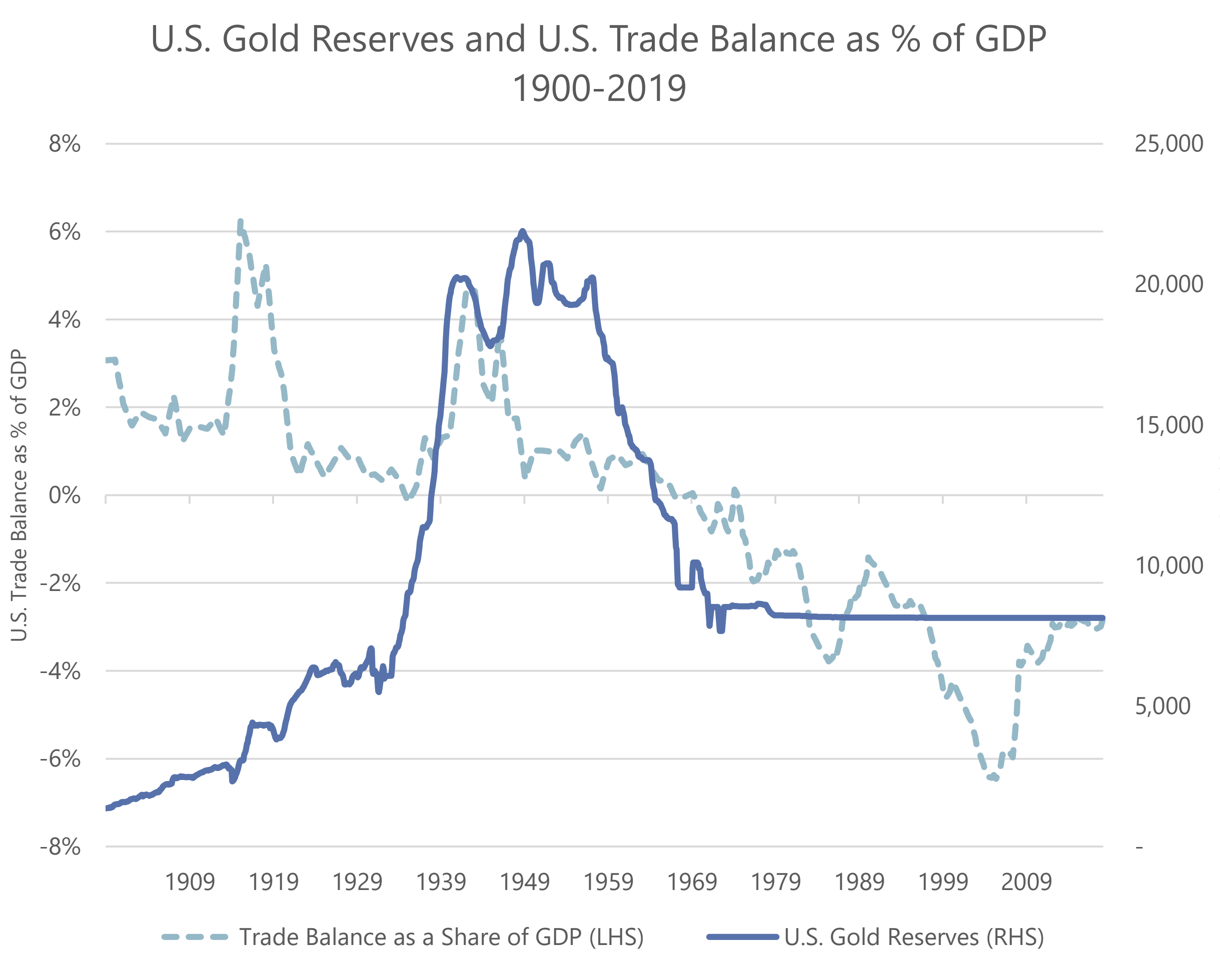
The U.S. domination of Bretton Woods, the IMF, and the status of the dollar did not arise from White's superior negotiating skills. It reflected the reality of economic, military, and political relations at the time. The U.S. gold supply had surged during WWI and rocketed during WWII, coming to account for roughly two-thirds of world reserves, and mirroring thereby the two chapters of war during which Washington achieved global hegemony.



Source: Federal Reserve Bank of St. Louis

American gold dominance reflected its industrial might. At the end of WWII, the U.S. dominated global markets for most agricultural and industrial commodities, and all the key manufactured items—automobiles, aircraft, petrochemical products, electrical products, and steel.

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5. The lessons of WWI and the failed peace of Versailles were fresh in the minds of the American architects of the postwar order. They well understood that without a stable capitalist order in Europe and Japan, the momentum of the "American century" could slip through their hands as it had in the descent into war and depression that was the heritage of Versailles.

   Beginning with Bretton Woods, the U.S. put in place a series of multilateral institutions that it would dominate: the IMF, the World Bank, the General Agreement on Tariffs and Trade (GATT), and the Marshall Plan. The Soviet Union and its satellite governments in Eastern Europe ("the second world") stood aloof from the economic and financial institutions but joined the United Nations and World Court.

   Drawing another lesson from Versailles—that Hitler and revanchist Nazi Germany were the bitter fruit of the victors' peace—the U.S. set about rebuilding its defeated rivals. Germany, it was assumed, would be the economic engine of Europe. Together with France, Benelux, and Italy, the U.S. funneled billions in reconstruction aid through the Marshall Plan and laid the groundwork for the Common Market (later the E.U.) through the rebuilding and integration of western Europe's steel and coal industries. Likewise, Japan was expected to become the economic heart of East Asia. Japan's relaunch was greatly aided by the American operations in the Korean War (1950-1953), for which it was the primary supplier.

6. There was no historical precedent for a war victor rebuilding its enemies and competitors. But American architects of the postwar order knew they had little choice. The alternative, as they saw it, was collapse, chaos, and, most worrisome, the potential for revolution: ruling classes in Germany and Japan were entirely discredited, and communists were already the dominant political force in France and Italy, and heavily armed in both countries. The landslide defeat of Churchill in 1945 at the hands of the Labour Party, which then adhered to a nominally socialist program, heightened U.S. concerns.

   The Americans, however, had planted the seed of a powerful contradiction in the Bretton Woods framework. In making itself the guarantor of postwar order on a global scale, Washington placed on its shoulders the Herculean task of "containing" the Soviet Union and rolling back the influence of nationalist and socialist movements all over the planet. The rebuilding and defense of Europe and Asia, followed by the Middle East, Latin America, and Africa, required a massive outflow of dollars.

The domestic corollary of these international policies was a "social contract" for American workers that entailed rising living standards, as we discussed in our CIO Perspective, *A Shifting World Order, Part I*. This was delivered primarily in the form of increased wages and benefits, and, secondarily, through social reforms. Wage increases contributed to the inflationary pressure on the dollar. Meanwhile, social reformism competed with military spending for government expenditure at a time when political calculations led American presidents to avoid paying for government spending through increased taxes. These issues came to a head in the 1960s during the Vietnam War.

Part II

1. This ultimately fatal contradiction, between an accelerating outflow of dollars on one hand, and protecting the fixed USD-gold conversion rate on the other may seem surprising given that the main crisis in the immediate postwar appeared to be just the opposite, coming in the form of a global dollar shortage.

2. Europe and Japan required American dollars to rebuild and to also purchase U.S. goods. The political imperatives of building a bulwark to Soviet influence allowed Washington to turn a blind eye, or even encourage, measures taken in Europe and Japan to protect and promote their industry and agriculture. Meanwhile, it supported the first wave of U.S.-based multinational corporations and banks launching operations abroad, which became a primary mechanism for the profusion of dollars overseas. When the U.S. balance of payments went negative in 1950, the news was viewed positively.

3. However, the "Eurodollar" phenomenon emerged on this basis. Initially, dollars in Europe were used to purchase American goods. But the wide circulation of dollars in Europe began to take place between and among both European and American international banks and investors, and some foreign governments. These dollar-denominated assets were not subject to reserve requirements imposed by either the U.S. Federal Reserve or the European central banks. Eurodollars were used in currency speculation, effectively bypassing the safeguards implemented by the architects of Bretton Woods to control capital flows, thus slowly undermining the system of fixed exchange rates.

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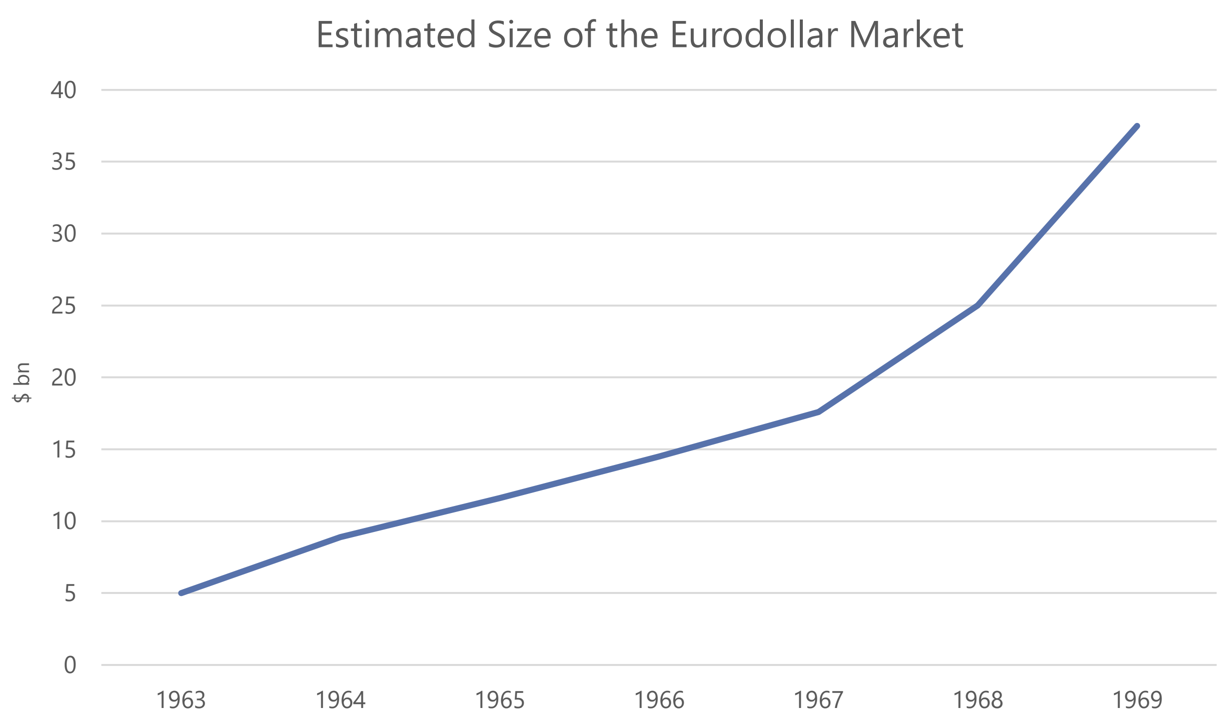
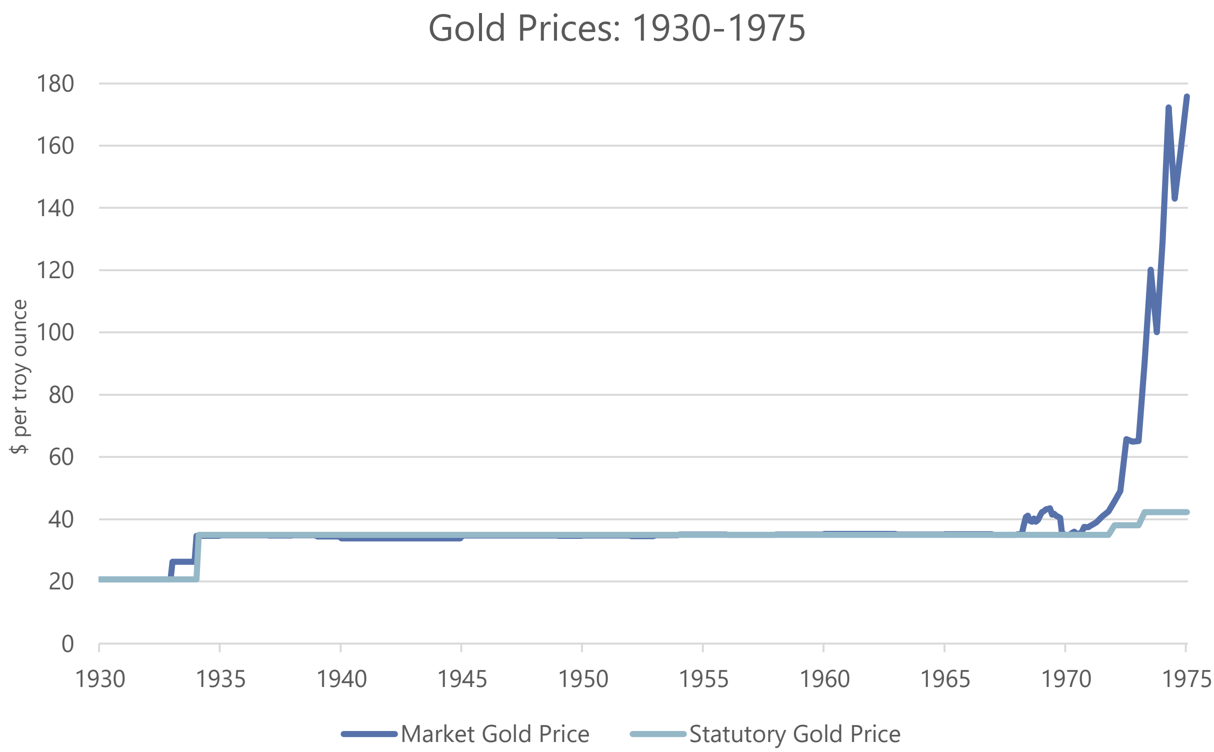


Source: BES Annual Reports, 1965-1970

The outflow of dollars from the U.S. for war, military bases and foreign aid was significant. But the central problem in the balance of payments emerged in the capital account portion, reflecting the growing activity of financial speculators in Eurodollars and similar markets. As time progressed, in the words of Jeffrey E. Garten, "private capital became a major force, perhaps the major force—in roiling the stability of currencies." This is precisely the outcome that Keynes, et.al. had sought to avoid.

4. By 1959, in testimony to the U.S. Congress, economist Robert Triffin had identified the fundamental contradiction within Bretton Woods. In what has become known as Triffin's Dilemma, he explained that the great expanse in the circulation of dollars abroad had outstripped the gold supply held at Fort Knox. As mentioned above, the expansion of the dollar supply was needed to provide liquidity, as well as to support America's expansive geopolitical ambitions. This generated a balance of payments deficit. But while the deficits were necessary for the global economy, they undermined the confidence in the U.S.'s ability to meet the potential claims of foreign dollar

holders on its gold. As the actual market price of gold increased, reaching $40 per ounce in the London market in 1960, the U.S. was faced with the prospect of devaluing the dollar by readjusting its peg from $35 per ounce of gold.



Source: Bloomberg, IMF

5. Alternatively, the various central banks could cooperate in a bid to drive down the market price of gold. This was the purpose of the London Gold Pool, joined by eight nations in 1961, where members coordinated to push down gold prices through targeted sales. The U.S. contributed 50% of the gold reserves in the vehicle, and seven European nations contributed the remainder. But this only delayed the crisis. The expansion of the dollar supply and inflation continued through the 1960s, and it became increasingly difficult to replenish the gold that had been sold with new supplies. In 1967, France withdrew, quickly followed by a rout of the British pound and its devaluation by over 14% in November 1967. The pressure then shifted to the dollar, and on March 14th, 1968, under pressure from Washington, the British government suspended the London gold markets (which remained closed for two weeks), while on March 18th, 1968, the U.S. Congress lifted the legal requirement for

25% gold backing for the dollar. Subsequent attempts to build a wall of separation between the reserve bank price of gold and the market price could not hold back the tide. In 1955 the U.S. had $21.7 billion in Bretton Woods-priced gold, more than enough to cover the liabilities owed to foreign reserve banks and governments, which stood at $13.5 billion. By 1971, the U.S. had only $10.2 billion in $35 dollar-per ounce gold, while there were more than $40 billion in outstanding foreign dollar holdings.

6. The erosion of Bretton Woods went side-by-side with, and was mutually reinforced by, the American debacle in Vietnam. The U.S. spent some $168 billion on the war—upwards of $1 trillion in current money. Simultaneously, the U.S. executed the largest expansion of the social welfare system since the 1930's, the Great Society, and wages continued to increase. These expenses were not matched by corresponding tax increases.

   Dollars became overvalued not only in relation to gold, but also to other currencies, especially the mark and the yen. This granted the export industries of Germany and Japan a significant advantage over the U.S., further exacerbating the balance of payments deficit and the outflow of both dollars and gold.

7. The crisis came to a head in early May 1971, when over $1 billion flowed into the Bundesbank in Germany, forcing the German government to close down its foreign exchange markets. Upward pressure on the yen also mounted. Several European governments began to demand an exchange of their dollars for American gold holdings. While Washington remained outwardly committed to the dollar's current role, the stage was set for Nixon's announcement of August 15th, 1971.

Part III

1. The collapse of Bretton Woods was followed by faltering attempts to arrange a new regime of fixed currencies, starting with the Smithsonian Agreement of 1971, based on a devalued dollar and a revalued mark and yen. The Smithsonian agreement and other efforts failed to stop the increase of capital flows. For all intents and purposes, a regime of free-floating currencies had been achieved within a few years of Nixon's announcement.

2. The European and Japanese governments were outraged by Nixon's maneuver. They recognized, together with the French Minister of the Economy, Giscard d'Estaing,

that the dollar was the United States' "exorbitant privilege." Because no currency could replace it as an international reserve, and because there could be no return to the gold standard, the U.S. could freely run up a massive balance of payments deficit, secure in the knowledge that it could finance them by selling Treasury bonds. And indeed, for a half-century, the U.S. has been able to lean on dollar dominance. The American attitude was summed up at the G-10 meeting in December 1971 by Nixon's Treasury Secretary John Connally: "It's our currency, but it's your problem."

3. The end of Bretton Woods held enormous implications, dropping the curtain on a prolonged period of economic growth known in the U.S. as "the long post-war boom," *Les Trente Glorieuses* in France, and variations of the phrase "economic miracle" in German, Japanese, and Italian. The period from the late 1940s to the early 1970s was characterized by steadily growing economic output and rising living standards. It was followed by decades of low-to-moderate economic growth in tandem with stagnating living standards. It is no accident that the numerous studies that document the increase in wealth and income polarization, especially in the United States, tag the early 1970s as the beginning of the phenomenon (for instance, the https://wtfhappenedin1971.com/ website includes a variety of charts dedicated to the topic).

4. The end of Bretton Woods did not resolve the problem of inflation or low economic growth in the U.S., the combination of which earned the name *stagflation*. The United States heaved from crisis to crisis throughout the 1970s. The OPEC oil shocks contributed to inflation as the oil embargo reflected the decline in American hegemony after the defeat in Vietnam. So did substantial strike activity by American workers over the decade, motivated by COLA demands—cost of living adjustments. Economists wrung their hands over what they called "the wage-price spiral." This period we discussed in detail in the second installment of our CIO Perspective, *A Shifting World Order*, *Part II,* "Ultra Capitalism at a Breaking Point."

   As we described, to resolve the strike wave and inflation, Federal Reserve chair Paul Volcker imposed his interest rate "shock therapy" in 1979, elevating the overnight lending rate past 20%. This drastically increased the value of the dollar, increased imports, devastating much of American industry, and exacerbating the balance-of-payments deficit. The damage was compounded by Reagan-era tax cuts and massive military spending, which increased the national debt. Volcker's interest rate increase, coupled with financial deregulation, gave a powerful impetus to the financialization of the American and global economy.

But d'Estaing's description proved accurate. Indeed, the dollar's powerful role allowed for such imprudent measures as destroying one's own industry to curb inflation while accruing massive balance of payments deficit and government debt—with little fear of investor backlash.

5. The dollar's status as world reserve currency has been augmented by the fact that the world's most important commodity, oil, is generally priced in dollars, a result of negotiations conducted by U.S. Secretary of State Henry Kissinger with Saudi Arabia in the aftermath of Nixon's abandonment of Bretton Woods. In return for a guarantee of American military protection, Saudi Arabia promised to denominate oil in dollars. The rest of OPEC followed by 1975. This created the market for so-called Petrodollars, dollars that were drawn out of underdeveloped oil-producing countries, where few profitable investment outlets could be found, back to the U.S., in part through the purchase of treasury bonds.

6. The regime of free-floating currencies allowed back into the world the very destructive forces that the planners of Bretton Woods had sought to contain. In the 1980s, debt crises gripped the Third World as governments were forced to pay back debts with dollars that were much higher in value than those they had borrowed. The Black Monday stock market crash of 1987 occurred days after the U.S. government announced an unexpectedly large trade deficit, precipitating a decline in the value of the dollar. In 1995, the appreciation of the dollar forced an IMF and U.S. government bailout of Mexico. In 1997, currency volatility precipitated a crisis in Thailand that spread through East Asia, threatening global finance. Later that year, Russia was forced to default on its debt and devalue the ruble. The Fed's easy money policies, only possible given the U.S.'s exorbitant privilege, have contributed to a sequence of bubble and crashes—the "dot-com" bubble of 2000; the housing bubble of 2007-2008; and the various bubbles that characterize the current U.S. economy.

Part IV

1. At present, the financial and economic media reflects growing fears that the post-Bretton Woods system that emerged in 1971 is nearing its end. That era was characterized in North America, Europe, and Japan by the use of deflationary pressures—the free movement of finance and the globalization of economic production—to counter the potentially inflationary effects of monetary expansion in an environment of free-floating fiat currencies.

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2. The fixing of the dollar to gold at $35 per ounce appears quaint in the present environment of SPACs and cryptocurrencies that are untethered to any concept of real value. As we write these lines, the cryptocurrency market value has topped $2 trillion. Tesla's market cap is currently ten times more than that of General Motors, when GM accounts for more than eight times greater market share than Tesla.

   The untethered character of these valuations finds a bizarre reflection in certain consumer markets, for example the art world. Recently, Italian artist Salvatore Garau sold an "immaterial sculpture"—in other words, one that doesn't exist—for $18,000.

3. Such manifestations must call into question not only the "objects" being sold but the currency in which the sales are conducted. It may be useful to return now to Triffin's Dilemma. When Robert Triffin pointed to the paradox confronted by the Bretton Woods system in 1960, what was at issue was not simply the uncertain value of the dollar relative to the gold backing it. It was more fundamentally the problem of a national currency playing the role of world reserve currency. The outflow of dollars was necessary to provide liquidity and support the entire global capitalist economy. But this necessarily resulted in U.S. deficits, undermining the actual value of the dollar.

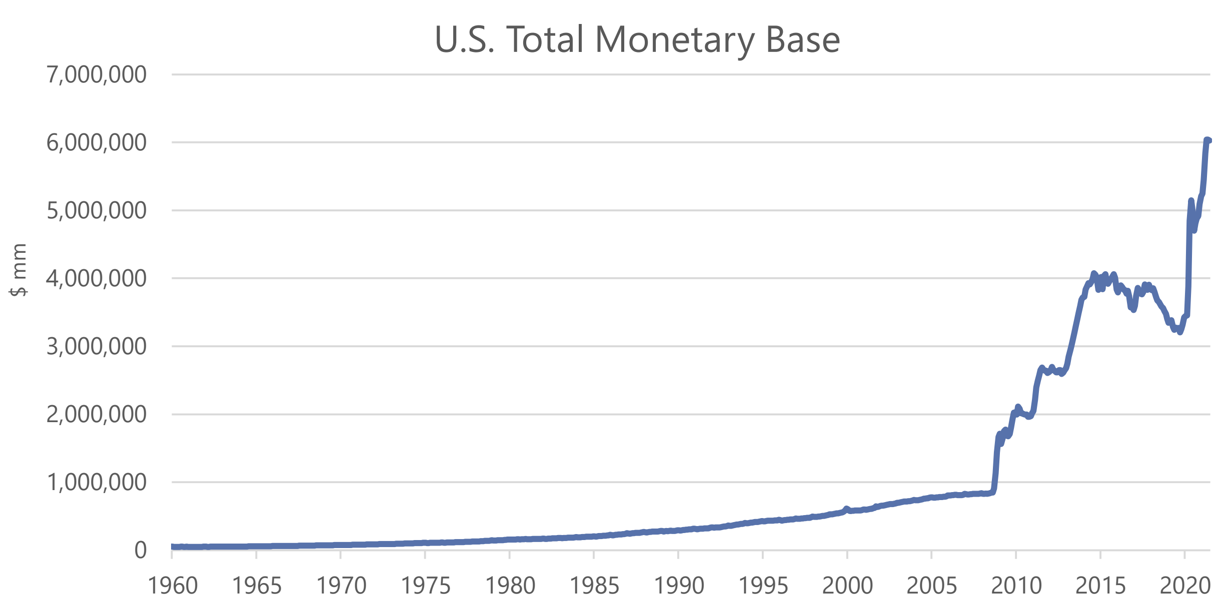
4. In that sense, Nixon's action on August 15th, 1971, did not resolve the fundamental contradiction. On the contrary, it has been heightened over the subsequent half-century. The quantitative easing and massive purchases by the Fed of Treasury securities that came in response to the Global Financial Crisis, and at an even greater magnitude after the Coronavirus Crash, coupled with ongoing, massive balance of payments deficit, and more recently with large-scale government stimulus and direct monetary relief—all of these have created massive uncertainty over the intrinsic value of the dollar, which has largely maintained its position only because no other currency can replace it as long as U.S. political hegemony is undisputed.

   Triffin's Dilemma pertains with greater force now than it did in 1971: If the U.S. effectively devalues its currency through inflation, it risks losing its "exorbitant privilege" while inciting a wave of domestic opposition and most likely heightened strike activity. If, on the other hand, it strives to maintain the value of the dollar, perhaps through a series of interest rate hikes, it risks toppling the financial house of cards, wiping out immense amounts of paper wealth, and creating a potentially severe recession, or even a depression. If no effort is made in either direction, some combination of both of the foregoing is likely to materialize.

Considerable evidence suggests that the U.S. establishment, most clearly in its economic and financial representatives in the administration and at the Fed, have concluded that the path forward involves allowing inflation to reduce the value of the dollar, a policy predicated on the lack of a potential alternative currency able to fill a similar role.

5. However, Joseph Biden, Janet Yellen, and Jerome Powell enjoy far less room for maneuver than their predecessors in the Nixon administration did. In 1971, the U.S. still accounted for over one-third of global economic output. That figure has fallen to roughly one-fifth. In 1971, America's vast internal market, still heavily oriented towards industrial production, shielded the nation to a great degree from global pressures. Trade as a share of GDP in 1970 stood at 8%. Today that figure is 26%. In 1970, the national debt stood at $370 billion. Today the figure is $26 trillion, and growing rapidly. Yielding to the temptation to inflate away these liabilities can only entail a great impoverishment of the American population, with all the social and political risks involved.

6. As we have argued in the most recent CIO Perspective, *A Shifting World Order, Part III,* the narrowing horizons of American capitalism tempt it to turn to its last overwhelming advantage, which it has maintained since World War II—its military strength. This would represent, in a certain sense, the final undoing of Bretton Woods, which aimed precisely at averting a return to the catastrophes of the 1930s and 1940s.



Source: Federal Reserve Bank of St. Louis

Conclusion:

A study of the rise and fall of the Bretton Woods system highlights several critical issues. (1) In the first place, it illustrates that the architects of that system were not primarily motivated by financial, or even economic concerns. Rather, these concerns served a larger aim: Controlling and suppressing the social crises, revolutionary upheavals, and wars that had punctuated the immediately preceding period. They believed that restraining finance in a regime of fixed currencies, based on U.S. dollar dominance, served that larger political aim. (2) However, their efforts to control financial markets proved illusory. The emergence of the Eurodollar market in the 1950s brought the first cracks in the dam that finally gave way with the scrapping of Bretton Woods altogether fifty years ago.

Flowing from those two points is an even more critical issue. (3) The entire experience of Bretton Woods demonstrates that the question of currency exchange, and the role of the international reserve currency, are not hermetically sealed from larger geopolitical issues. On the contrary, the experience illustrates the way currencies are, in large measure, barometers of broader historical developments. The dollar, and the Bretton Woods system that supported it, rose with the industrial might of the U.S. and eroded with its relative decline. This became undeniable in 1971. The system of free-floating currencies that replaced Bretton Woods has held sway for the past 50 years. But, as was the case with Bretton Woods, underneath the surface, the position of the U.S. has also been steadily eroded. We believe that that development is reaching an inflection point.

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