THE EVOLUTION OF THE US DOLLAR AS QUASI WORLD MONEY

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First Draft

AUGUST 2009
1. Introduction

“The United States is today the storm center around which international monetary problems revolve.” (Hansen 1965, p.1). This is so much true for the time it was written, as it is for our days. Nevertheless, the main concern of this paper is not how the US found herself in such a position; rather, the issue at hand is how the International Monetary System (IMS) evolved from one based on gold, to one based on the US dollar. It is argued here that this was the result of a historical process that started as early as 1914.

The main argument is that the evolution of the IMS reflects the underlying changes in the form of world money that an IMS is based upon. Having said that, it is apparent that, during the interwar and the Bretton Woods era, world money was striving to renounce its golden substance, although this was not possible until the collapse of Bretton Woods. It is in this sense that the period between 1914 and 1973 is considered as transitional.

World money is a distinct function of money only in the Marxist literature and this is the theoretical framework used here. According to Marx, world money can be served by the form of gold bullion, as the most recognisable form of money in the world level. This consideration originates in the underlying analysis of the forms of value, according to which money stems from the commodity and the commodity production. “Gold is now money with reference to all other commodities only because it was previously, with reference to them, a simple commodity.” (Marx 1976)

On the other hand, the US dollar is credit money with legal tender. It is born as such, by the bank of the banks, with the trustworthiness of the state, rather than the mere enforcement of the latter (Papadatos 2008).

The reasons for the transformation of world money are seen here as threefold. First, capitalist production was constraint by the volume of the production of gold. This is a tendency of generalised commodity production that was affirmed historically, especially during the interwar period and it also gives ground to the evolution of credit and credit money.

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1 There is a debate still active as to when did the Bretton Woods actually collapsed. For the purposes of this paper, to take position as for the actual date – whether it was 1968, 1971 or 1973 – is not considered important.
Then, it was a major shift in the structure of transactions which wasn’t anymore based exclusively on trade, but also interstate payments, foreign direct investment, portfolio acquisition and other flows of money that could not transform into productive capital in the domestic economy. Gold proved improper for such movements due to its magnitude, allocation as well as its readiness and easiness to move around the globe.

Finally, class struggle evolved significantly in the century of the workers’ revolutions. Gold was a weapon whose barrel was not showing always the right target, from the point of view of imperialism. In this respect, the fact that the USSR commanded large volumes of gold, the related collapse of colonialism that unbound colonies that commanded gold stocks, like South Africa, the related political uneasiness to alter the exchange rate between the US dollar and gold, and the immediate need for independent monetary policy in order to manipulate class struggle domestically, with the carrot and the stick; all these factors made gold seem more as a burden rather than a useful anchor for the IMS.

At the same time, the major capitalist countries scrambled to resolve the problems at hand, with no conscious or collaborative plan, always driven primarily by the interests of their national bourgeoisies. The role of the state changed accordingly, with the latter undertaking responsibilities previously unknown. Antagonism between capitalists in the international level was intermediated by the state, mostly indirectly, but occasionally directly. This chaotic perplexity was the main feature of the interwar period, which was characterised by the rise of the US as the new dominant power, but with all the other players well in shape.

The Second World War simplified things a lot. However, it was not possible for the IMS to be released from its “golden fetters”. The main reasons can be found in the inexperience of the states to manage world money, the very effects of the war, the absence of the necessary international framework and the necessary institutions to implement it and the fact that the US had just confirmed its dominance in the political military and economic level. The US dollar was not used extensively in world transactions, and definitely not as extensively as the British Pound.

Still, the US dollar could not be adopted as world money at the time, not because it lacked the trustworthiness of the US, or because this trustworthiness was not good enough – after all, it was all the capitalist world had. What was questioned and made the US dollar unreliable to lift the IMS on its shoulders, even for the
Americans, was its credibility as measure of value. In other words, it could not reassure the world that it could speak well the languages of all commodities and express their value in world prices. For this, the US dollar needed the backing of gold. Essentially thus, and for the examined period, gold never stopped functioning as the measure of value for the world economy, and in this sense it provided the anchor for the IMS.

During the Bretton Woods, the potentiality for the diminution of the role of gold as world money was gradually built. The necessary institutions were established, the Central Banks evolved as the backbone of the international financial system and state administration became efficient in managing short term liquidity and solvency problems, by manipulating all the available economic and political means.

It is still questionable whether the collapse of Bretton Woods was a failure or a success. Most probably it was both, depending on the point of view and on the answer to the crucial question: for whom? The result is that, through this historical process, the US dollar evolved as de facto world money, although quasi because it solved the problem of its being unanchored and therefore imperfect as measure of value like Great Alexander resolved the Gordian knot: it cut the rope that linked it to the anchor and was let afloat, since others would carry the burden of any anomaly.

The main question that lefts unanswered is what the US dollar cannot do without gold backing it in the post Bretton Woods IMS?

The structure of the paper is as follows: the next part considers the basis for the historical evolution of world money; the main focus here being on the underlying necessity for the transformation of world money. The third part explores the reasons for which gold was so difficult to be replaced and gives an overall account about the evolution of the means needed to overwhelm its resistance. The final part examines why the alternative plans that were proposed, mostly during the Bretton Woods and in order to remedy the inherent weaknesses of the Agreement, could not apply, neither at the time, or even later.

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2 It is evident that gold has not been retreated, and certainly not diminished, still carrying a “mission impossible”, that of the hoard of last resort. In any case, its monetary role in general was never questioned; what was contested was its being world money.
2. The basis for the historical evolution of world money

2.1. The period: 1914 – 1973

From the foundation of the Federal Reserve System in 1913, until the collapse of Bretton Woods in the early 1970s, a lot of things happened in order to end up with the famous motto “our dollar, your problem”. Amongst them, two to three World Wars (including the Cold War) and a number of peripheral ones, the October Revolution, the so called Great Depression, the collapse of the British Empire, a few monetary crises but also the Golden Age of capitalism and the foundation of numerous monetary institutions.

Following the evolutions of those turbulent years, the IMS transformed from the Gold Standard to a US dollar based one, passing through the status of an anomalous mixture in the interwar period and of the Bretton Woods System. Examining the IMS with the criterion of its correspondence with the underlying form of money on which it is based, the Gold Standard and the US dollar system that prevailed after the collapse of Bretton Woods exhibit a completion, leaving the intermediate situation seem as transitional from the one to the other.

In the years of the Gold Standard, the dominant function of money, that of world money, was served best by gold, in the form of bullion. The need for such a function of money, in the first place, stems from it being recognizable when leaving the home sphere of circulation. The main point is the universal reflection of the value of commodities that speak different languages. Bagehot claimed that “[t]he advantage in a universal money is not as medium of exchange, […], but as unit of account, in enabling foreigners to understand English price language […]” (Kindleberger 1993, p.69, emphasis in the original).

The content of that function rests not in revealing the differences in the levels of productivity, exploitation and intensification of labour in the production of those commodities; on the contrary, it rests in suppressing those differences so that the norm of value can be expressed in a recognizable form (Marx 1973).

“When money leaves the home sphere of circulation, it strips off the local garbs which it there assumes, of a standard of prices, of coin, of tokens, and of a symbol of value, and returns to its original form of bullion. In the trade
between the markets of the world, the value of commodities is expressed so as to be universally recognised. Hence their independent value-form also, in these cases, confronts them under the shape of universal money.” (Marx 1976)

This is exactly why gold had to be in the form of bullion and not in any other form, subject to debasement or any other kind of manipulation.

After the collapse of Bretton Woods, the function of world money was performed by the US dollar (Williamson 1976, McKinnon 1993) the latter having being characterized recently as quasi-world money (Lapavitsas 2009). The US dollar is primarily credit money with legal tender, with no gold, or other commodity, backing, not subsumed to the laws of commodity production, but only conforming to them. In that sense, the IMS that is based upon it is different in nature from the Gold Standard, having cut almost all the links with the latter.

On the other hand, the IMS in both the interwar and the Bretton Woods era could not cut the golden nave string, yet striving to assume a non-commodity basis. In this process, every failure was accompanied by a step forward. Every monetary crisis, every war, although troubling and putting into test the current IMS, it was always leaving behind a useful and necessary element for its evolution.

From that point of view and ex post, the years that followed the first collapse of the Gold Standard in 1914 until the collapse of the Bretton Woods, and the IMSs that rested upon them, are seen as transitional. “The present [1961, GL] crisis of the dollar is in fact inextricably bound up with the ill-fated attempt to dig up and dust off an international monetary system which collapsed nearly half a century ago, during World War I, and which must be thoroughly overhauled in order to adapt it to present-day needs and conditions” (Triffin 1966, p. 241)

One should turn one’s interest in those years, in order to approach those “needs and conditions” that led to the alteration of the form of world money which found its way in the events of the early 1970s.

2.2. The need for the transformation

Production altered significantly in the late 19th century and the change continued well in the 20th. Two major and succeeding processes revolutionized production, namely Taylorism and Fordism. Originating in the need of an autonomous
management and forcing production automation, Taylorism offered to the management the possibility of achieving only with automatic means what it was just striving before to accomplish with organizational and disciplinary means. The motive was no other than the rise in productivity, in other words, the effort of finding ways to incorporate even smaller quantities of labor time in even larger quantities of product (Braveman 1974).

Fordism went on transforming the production process, subsuming further the technical division of labor to the social division of labor. As it was expected, both processes led to major changes in the productive forces. Machines became better, more efficient, longer living and cheaper. Workers became more skillful, although the production process was simplified, more productive and cheaper. The capital circuit became faster. The result was the elevation of accumulation to previously unknown heights.

The state undertook crucial activity, providing the industry with the necessary infrastructure the size of which was proportional to the expansion of the capital. It took over ventures that would be impossible for individual capitalists, or even groups of them, to finance. In some cases, the state acted as a capitalist itself in areas that were not profitable for the capitalists, but still necessary. Parallel to the rise of the significance of the state, rose the conduciveness of the national budget to the GNP.

The rise in the accumulation in combination with the success of the state, led capitalists out of the national borders in the quest of both profitable placement of their capital and cheap raw materials. International transactions rose in magnitude, even in periods of stagnation in the big capitalist countries. The production of gold could not follow the evolution in the international transactions, even if it wasn’t for the October Revolution depriving the world from the Russian gold stock and, more important, from its gold mines. “Gold has long ceased to provide adequate amounts of international liquidity for an expanding world economy” (Triffin 1960, p.87)

After all, the labour power and the means of production that are consumed in the production of gold as an instrument of circulation is a burden for the capitalist mode of production, part of the latter’s faux frais.

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3 USSR gold sales were far limited to counteract this fact.
4 “[…] the world liquidity requirements can certainly be put to better use than the financing of more and more earth-digging in South Africa, the USSR, Canada, the United States and Australia” (Triffin 1960, pp. 81-82).
This is an “expensive machinery of circulation”\(^5\), for which the decline in the expenses raises the productive force of social labour (Marx 1978).

“Hence, so far as the expediencies developing with the credit system have this effect, they increase capitalist wealth directly, either by performing a large portion of social production and labour-power without any intervention of real money, or by raising the functional capacity of the quantity of money really functioning.

This disposes also of the absurd question whether capitalist production in its present volume would be possible without the credit system (even if regarded only from this point of view), that is, with the circulation of metallic coin alone. Evidently this is not the case. \textit{It would rather have encountered barriers in the volume of production of precious metals”}. (Marx 1978, ch. 17, emphasis added)

Keynes had argued as well that gold production is very small for the whole world (1936).

Accordingly the structure of the international transactions changed. In the years before WW I, during the Gold Standard, trade prevailed and accounted for the biggest part. Later on, two other than trade categories are becoming more and more important, namely interstate payments (in the form of war reparations, grants and aids and secured loans) and international investment (export of monied capital, either in the form of Foreign Direct Investment (FDI), portfolio acquisitions or speculative capital\(^6\)). It can be argued that the former set the stage for the latter.

“In a world where international transactions consist not only of commercial transactions but also of politically induced movements of money, competitiveness of a country with political net payments has to be stronger than it would if international transactions were governed exclusively by commercial consideration” (Walter Ledeler in Harris 1962, p 133)

This was the case for the Bretton Woods era in particular, where the US just after WW II, fed the world with dollars through the Marshall Plan, military expenditures abroad, grants, secured loans and direct aid. That money was given to

\(^5\) “Nobody could ever have conceived of a more absurd waste of human resources than to dig gold in distant corners of the earth for the sole purpose of transporting it and re-burying it immediately afterwards in other deep holes, especially excavated to receive it and heavily guarded to protect it” (Triffin 1960, p.89)

\(^6\) Lenin argued that it is not only very difficult to distinguish between productive investment and speculative position, but also methodologically erroneous and flat (Lenin 1916)
come back, and it did return through several channels, the more prominent of which involved the rise of the US exports, either imposed by the terms of the loan or by necessity, the repayment of the loans etc. In other words, the US financed themselves (Triffin 1966, Tew 1977).

Gold is not proper to the nature of the international transactions other than trade. The goals of interstate payments made in gold, to begin with, are not ensured. Let us consider the case of an untied loan, from the US to a European country, in gold. The debtor might use the money to raise its imports from the US, but it might also not. It might use it to buy from another country, or even hoard part of it. If the loan was in US dollars, the form by itself would act as a clause that money would return eventually in the pockets of US corporations.

In the case of international investment things are essentially the same. “[…] investment opportunities appear to have been better elsewhere [elsewhere than the US, GL].” (Hansen 1965, p 27) Capitalists need for their national means of payment to be accepted outside their national borders. If it wasn’t the case, they would need gold, in which case two constraints would apply: first, they would weaken the ability of their country to perform its monetary policy in both the international and national level and second, therefore, they would be constrained in acquiring the golden key that opens all doors.

For the completeness of the argument, we have to note that if those transactions were made actually in gold, this would incur a very pragmatic bar in the transactions themselves. Shipping gold is not only costly, dangerous and, at the end of the day, parasitical for the marketers, but also prohibitive for some transactions that have to occur in due time. Claims and debts are infinite and it is impossible to carry gold here and there, from one point of the globe to the other, so that payments are transacted. There is thus need for a practical and flexible means of payment (Kolloch 1981).

The final source of necessity for the transformation of world money involves class struggle which was altered significantly in the 20th c. in three ways. First, due to the October Revolution and the establishment of the USSR that gave the grounds, for the first time in the history, to the antithesis between the capitalist state and the socialist one. This antithesis was aggravated due to the fact that the USSR

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7 In the imperialist stage of capitalism, it can be argued that gold is not proper to the nature of trade as well.
commanded huge stocks of gold and therefore, on the one hand diminished the available world stock of gold and its annual output; on the other hand, it was always considered as problematic for the socialist bloc to acquire such a potential financial independence. (Triffin 1960)

Then, it was class struggle in the interior of the countries which was fostered by the division of the world into two parts. The state again had to manage the self-organization of the workers in the course of the long run interests of the bourgeoisie. For this to happen it had to assume the welfare state and at the same time organize the repression of the workers. The growing attention paid to the problem of unemployment undermined the gold standard (Eichengreen 1992). Both processes became more and more important, especially after WW II, when Keynesianism became the dominant dogma and they are reflected in many authors of the era.

Finally, it was struggle between groups of capitalists intermediated by their national states or alliances of national states. The interesting change here concerns, on the one hand, the intermediation of class interest from the national states. This contributed essentially to the outgrowth of the administration and consequently stretched the problem of finance.

On the other hand, it is interesting to spot the collapse of the British Commonplace and in general of colonialism that took place gradually, in the course of years from 1914 until the 1960s. Apparently, the direct form of depression could no longer be sustained and another process should be put in its place. What Keynes wrote about the Germans held for colonialism in general

“It would be a surprising triumph for propaganda to make an up-to-date version of imperialist exploitation verging on slavery seem attractive to the victims” (Keynes 1980, p14)

Still, the collapse of colonialism meant that the core countries could no longer control the gold producing countries in their peripheries as they used to do before. The most exceptional case is South Africa.

To sum up, the evolution of capitalism in the 20th century was constraint by the form of world money. The process of integration of world market demanded an unpredicted allocation of gold reserves, which only by accident would coincide with the actual allocation and the potential acquisition of gold through direct or indirect control of gold mines. The collapse of colonialism and the establishment of USSR posed further constraints on an already bounded problem.
As for the quantity of gold, it is not enough to contrast the gold reserves with
the level of world accumulation, even if good approximation about the velocity was
given; the issue was not only if gold was enough to accomplish the annual world
transactions, but whether it was in the right quantity, in the right hands, at the right
moment. In a chaotic world market, this was purely a matter of luck, unless the world
market could get rid of gold and use credit money, which could be provided, under
some limits, at will.

But gold could not go away for good, at least not yet. The main reason is that
it provided for the anchor of the IMS, being exclusively serving as the measure of
value.

2.3. The interrelation of powers: the dominance of the US

It is evident that the history of the first three quarters of the 20\textsuperscript{th} century is not
the result of any conscious plan. Instead, the process of the diminution of the role of
gold as world money followed the interrelation of powers and the constraints of
capitalism in its monopoly stage and it is in this sense incomplete and contradictory.

“The substitution of debt or paper money for commodity money within each
country’s national borders was a slow, gradual, and still recent phenomenon in
world affairs. Its extension to the international sphere is even more recent and
has also developed haphazardly under the pressure of circumstances rather
than as a rational act of creation on the part of any national or international
authority. This explains the present and totally irrational use of national
currencies as international reserves.” (Triffin 1960, p. 90, emphasis in the
original).

Antagonism between capitalists and capitalist groups was deployed in the state
level and this perplexed things even more, since class struggle was in all levels
intermediated. Finally, the Cold War put more constraints on top, especially since the
USSR was one of the most important gold owners and holders in the world. History
plays funny games.

What would the evolution of the IMS be, had the USA and the UK had the
subsoil of the USSR and of South Africa, as interesting a thought experiment as it
might be, is still a question with no answer. Most probably, the result would
eventually be the same, more or less, although the process would have been much smoother and easier, ceteris paribus of course. One may not argue the same, hadn’t the state played its upgraded role.

The WW II was a historical benchmark for all the above processes. Seen from the point of view of its impact on the process of expanded reproduction, the war was very stimulative. It resulted in the physical destruction of productive forces, accelerating the death of obsolete lines of production. In the course of the war, all countries pushed their national corporations to incorporate as soon as possible every innovation into production in order to gain comparative advantage towards both allies and rivals. And after all, the world was rebuilt from the ground up, utilizing all the experience acquired up to, and during, the war (Bordo 1995).

The WW II also forced the acceleration of the rise of international transactions other than trade. In combination with the form that class struggle took during, and due to, the war, there were few choices for the leading capitalist countries. This includes both the countries that experienced heavy destruction during the war and the US. The latter was already in salience.

The transformation of the production process referred to above demanded for a widening and deepening of the wage relations in all major capitalist countries. For numerous reasons that lie beyond the scope of this paper, the wage relations were integrated in the US faster than anywhere else and this put the US in the center of the capitalist world (Aglietta 1979).

Further, the US was benefited from the outcome of both World Wars, and thus the US based corporations strengthened their position towards their competitors in Europe; in the UK, France and Germany mostly.

“The WW I strengthened the competitive position of American industry and transformed the US from a net foreign debtor to a creditor nation. […] It fundamentally strengthened America’s balance of payments position and weakened that of other parts of the world.” (Eichengreen 1992, p. 392)

The WW II in specific left the American firms with no competitors. Additionally, the reconstruction of the world demanded international credit that could be provided only by the US.

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8 With the exception of Switzerland, the US was the only creditor nation after WW II (Halevi and Varoufakis 2003)
Other authors have claimed that the America’s comparative advantage stemmed from the flexibility of its labor market and its individualist – as opposed to corporatist – entrepreneurial culture (Halevi and Varoufakis 2003).

Thus, the most striking effect of WW II was the accreditation of the dominance of the US in the capitalist world.
3. The resistance of the old and the means to overwhelm it

3.1. Persistence of gold as world money

Despite the changes described above that announced the dominance of credit money in the international scene, it was not so easy for gold to be put aside.

In the interwar period, many attempts were made in order to build an IMS without gold in its center. In the literature, these attempts are seen as efforts to restore the Gold Standard (Drummond 1987). Essentially, and irrespective of the legal framework, money was gold in the world level for the whole period.

This became more than evident in a number of contingencies later on. The most revelatory one is beyond doubt the case of the Bretton Woods negotiations. Although the Keynesian proposition was for the issuing of a purely credit money, with very restricted international role for gold, the Americans preferred to back their own credit money with gold (Keynes 1980).

Even after the restoration of convertibility of the European currencies in 1958, gold reminded the significance of its existence for the IMS in many occasions. Selectively, one may refer to the Gold Rush in October 1960 and the events of March 1968 that led to the suspension of convertibility of the dollar. In all the occasions that the US dollar was shaken, this was due to the lack of confidence that it would be convertible to gold at a specific rate. In 1964 “international cash still consists very largely of gold” (Hansen 1965, p. 59)

Both the dollar shortage first and the succeeding dollar glut were related to gold. As a matter of fact, they were referring to gold reserves perversely: the dollar shortage was relative plethora of gold reserves and the dollar glut was relative shortage of gold reserves backing the international function of the dollar.

“The very countries that should lend to the others [referring here to the US primarily, but also the UK, GL] are thus unwittingly borrowing short term capital from them. These capital movements do not, by themselves, relieve the gold shortage, but merely disguise it as a shortage of the key currencies in question.” (Triffin 1960, p. 145, emphasis added)
The fact is that from the early 1960s onwards, gold was obviously not enough and new production could not keep up with the rise of the world output, even if we consider that the development of the financial system must have raised the velocity. Triffin’s dilemma was proven to be substantive although the outcome was different from what Triffin himself expected.

At the same time, gold was hoarded privately and in the early 1960s some estimates place the amount of private hoards at around one third of the aggregate monetary gold at the time, well over $15bn. In the IMF’s report for the year 1960 it is argued that “it is in the interest of the Fund members that gold should be available in official reserves rather than go into private hoards” (Hansen 1965). It seems that private hoards were in principle responding to needs for future payment, rather than overflow of the channels of (world) circulation, counteracting capital movements’ restraints. Private gold hoards prove once again the significance of gold as world money.

The most profound reason though for the persistence of gold in the IMS was its appropriateness as measure of value. In this role, gold seemed irreplaceable. All the plans that have been produced on the grounds of the dollar glut, the Triffin dilemma and the dead end that the IMS was seemingly approaching, stressed the significance of gold as measure of value. Some of those plans were keeping gold as measure of value (Zolotas’ Plan, Triffin’s Plan and Hart-Kaldor-Tinbergen Plan), while some others tried to find a way to replace it (Keynes’ Clearing Union, Maxwell Stamp Plan, Hansen’s Plan and Bernstein’s Plan). But “every reform proposal […] contains some element of an exchange guarantee. To this there is not I believe, a single exception.” (Hansen 1965, p. 120)

3.2. The historical conditions

In 1971, the IMS could have collapsed following the collapse of the Bretton Woods Agreement, but it didn’t. It proved experienced enough to deal with the new dominant form of money in its center, namely, credit money and the US dollar in
particular. This potentiality was essentially the result of a process that started in the eve of WW I.

It was then that gold was withdrawn from circulation and concentrated to the Central Banks; and these banks have not released it. More than 90% of the monetary gold was held by Central Banks and governments in the early 1930s (Keynes 1930, vol. 6). This move was necessary for gold to be delegitimized as means of circulation, a function that could be well served by symbols already.

“[…] almost throughout the world, gold has been withdrawn from circulation. It no longer passes from hand to hand […]. Gold is out of sight […]. But when gods are no longer seen in a yellow panoply walking the earth, we begin to rationalize them; and it is not long before there is nothing left.” (Keynes 1930, vol. 6, p. 260)

Further measures were taken to economize on gold in the interwar. By reducing the gold cover for domestic currencies, it was freed for international use and in the end of WW II gold was concentrated in the US, either to be secured against the threatening situation and finally the outbreak of war, or as a result of the US surpluses before and during the war. Until 1944, the US held 60% of the world gold stock (Hansen 1965).

The role of Central Banks was essential in this process. The challenges of imperialism dictated the establishment of Central Banks in the countries that didn’t have one and the transformation of the already existent into a banker’s bank and a government’s bank. With the backing of the state, the Central Banks gradually monopolized the issuance rights of domestic legal tender (see selectively Kindleberger 1993, Itoh and Lapavitsas 1999).

“[…] the universal disappearance of gold coin from active monetary circulation has deeply modified the significance of Central Bank liquidity. Reserves need no longer be held to convert bank deposits and paper currency into legal tender for purposes of domestic circulation. Reserve drains are now associated exclusively with external deficits in the balance of payments of the country.” (Triffin 1960, p. 32)

9 “Even the traumatic breakdown of fixed exchange rates in 1971-73 did surprisingly little subsequently to disturb the conventions for using the dollar as international money for official and private purposes.” (McKinnon 1993)

10 It is revealing that the Federal Reserve System was established just one year before the outbreak of WW I, in 1913, while the Swiss National Bank was established in 1907.
In the whole period under examination, from the collapse of the Gold Standard until the collapse of Bretton Woods, the Central Banks of the major capitalist countries led the international financial system in acquiring the experience needed for the management of an IMS which lacked the automatic mechanisms of the Gold Standard. As a matter of fact, the international financial system reached manhood, so to speak, through the Central Bank interplay and the latter emerged as the backbone of the former.

This happened gradually; it was a process incurred every time by the historical contingency and passed through failures and successes. From the role Central Banks were called upon to play after the Genoa Conference in 1922, until the gold pool that was set up in London, after the Gold Rush in October 1960, a lot of steps were taken so that a complex and sophisticated mechanism was in order in the early 1970s to meet President Nixon’s proclamation, in August 1971.

There is no reason to reproduce here these steps, since the literature is quite extensive\(^{11}\) and shows adequately the logical sequence that led from one to the other. It can be said that this process involved a good deal of financial innovation and experimentation in managing short term liabilities (Fed swap network, foreign exchange transactions, rescue facilities etc) and transforming them into longer ones (Roosa Bonds, government securities with managed maturities etc), so that liquidity shocks could be easier avoided. A net of “overlapping arrangements of a short-term nature […] have succeeded so far in their modest attempt to meet the recurrent crisis triggered by the system itself” (Triffin 1966, p.42)

The international financial system developed also spontaneously, following the development of national financial systems of major countries, as a result of the need for capital export and in order to bypass the limitations imposed by the Bretton Woods. This process involved banks opening branches abroad and using afterwards those branches to bypass domestic legislation or international agreements. A special case was the Eurodollar market which was set up spontaneously, anticipated the suspension of convertibility of the dollar into gold, in March 1968 and acted as a valve to counteract its effects.

\(^{11}\) See selectively Tew 1977 and Yeager 1976.
Finally, the IMS did not collapse in 1971 due to the establishment and the following evolution of international institutions\textsuperscript{12} as well as a number of agreements that had already in the early 1970s set up a framework for the IMS\textsuperscript{13}. It can be said that those institutions didn’t play always the role they were assigned to, but the fact is that they provided the pylons for the international management of unanchored world money.

Finally, the states had an upgraded role in orchestrating this evolution. It is beyond doubt that this transformation would hardly occur without the backing of the United States, the states of the UK, France, Germany and, later on, Japan.

The result is that in the course of Bretton Woods, the US dollar evolved as de facto international means of payment, before becoming de jure as well, in the post Bretton Woods era. “With convertibility at an end, the world was on a de facto dollar standard rather than on a genuine gold-exchange standard\textsuperscript{14}.” (Yeager 1976, p. 575, emphasis in the original)

3.3. The collapse of BW\textsuperscript{15} and the US dollar as quasi world money

In the late 1960s, US direct investment abroad rose sharply and amid the Vietnam War contributed largely to the explosion of the US deficit. “As citadel of the capitalist system, center of technological innovation, generator of current saving from the world’s largest national income, and home of a highly developed capital market, the US was a natural source of large-scale direct and portfolio investment for the rest of the world.” (Yeager 1976, p. 586) It is reminded though that the Bretton Woods Agreement did not allow for capital flows.

At the end of 1967 there’s a surge of gold buying to arbitrage with an anticipated devaluation of the dollar. This was the final crisis in the history of the London inter-central bank gold pool. In March 1968, the gold pool collapsed. It was set up to anticipate events like the ones that led to the gold rush in October 1960, that is, a run in the bank.

\textsuperscript{12} E.g. the IMF, the OECD, the BIS, the IBRD, the European Payments Union, the European Fund, the European Investment Bank, the Colombo Plan, etc.
\textsuperscript{13} E.g. the General Agreements to Borrow, the Basle Credits etc.
\textsuperscript{14} Note that Yeager here is referring to the suspension of convertibility of March 1968.
\textsuperscript{15} This passage draws the historical events mostly on Tew 1977 and Yeager 1976
That was a landmark since the de facto convertibility of the US dollar came to an end for private residents for sure and in a less clear-cut way for foreign official agencies as well. This event led to the separation of official and free-market values of gold. The dollar’s conversion into gold for official holders ceased in 1968 to be a matter of routine. It became a matter of negotiation.

By August 1971 liquid dollar liabilities to foreign official institutions were more than three times as large as US reserves, and even larger losses were threatening. Anticipating dollar devaluation, “hot” money flowed out of the US in 1970-1971. The dollar glut had already become a dollar overhang.

How to maintain convertibility as the stock of dollars held by foreign official institutions grew and the US own stock of reserve assets, mainly gold, shrunk? In August, President Nixon finally denounced the convertibility of dollar into gold and dissociated the value of the former with the latter. It was a matter of time before the devaluation of the dollar.

Interestingly enough, the process of devaluation of the US dollar led the US dollar reserves of foreign central banks skyrocket. “The peculiarity with officially held dollar balances is that they have been acquired more or less involuntarily in connection with exchange-rate pegging or intervention. Dumping of official balances, though unlikely, could bring disruptive sudden changes in exchange rates and balances of payments.” (Yeager 1976, p. 581, footnote 59, emphasis added)

Of course, there were other reasons for the dollar overhang. The US compelled the rest of the world to keep financing the US deficit. This capacity hinges on its political dominance over the rest of the world (Halevi and Varoufakis 2003).

The German and Japanese governments explained the accumulation of dollar reserves as a price their countries needed to pay for the security provided by the US. Indeed, the Bundesbank president, Karl Blessing, in March 1967 signed the so-called Blessing letter, in which he committed the Bundesbank not to exchange its surplus dollars for gold in an explicit recognition that this was the price that Germany needed to pay for the maintenance of the US military presence in Germany (Bordo and James 2006).

All the same, the weakness of the dollar led to its further establishment. “As an international medium of exchange, the dollar has remained the dominant vehicle currency for interbank clearing for more than 90 percent of spot and forward transactions in the private foreign exchange markets” (McKinnon 1993). For, in their
effort to support the value of dollar and alleviate their damages from a subsequent devaluation, surplus countries like Germany and Japan tried to support the dollar through open market interventions – purchases mostly. Even without any officially announced dollar peg, direct official intervention in the foreign exchanges has been about as extensive since 1973 as it was under the old system of fixed parities (Williamson 1976).

The whole effort of preventing Bretton Woods from collapsing had entailed massive purchases of dollars around the world as central banks and governments strove to maintain fixed parities and keep their currencies from rising against the dollar (Yeager 1996). It seems thus that the US dollar emerged officially as quasi-world money at the time that its credibility to perform the measure of value function in the world market was in its nadir.

As a consequence of the dead end faced in the early 1970s, the major industrial countries accepted the economic reality and institutionalized floating (Gilpin 2002).
4. Instead of conclusion: what could have succeeded the collapse of Bretton Woods?

The historical events that led to the collapse of Bretton Woods are more or less known. Apparently, the substance of the Triffin dilemma burst with a kind of a run in the bank, the latter being in this case the Federal Reserve. Triffin diagnosed the dead end of the dollar glut: the US should keep on providing the world with liquidity through her overall deficit, but this weakened her ability to stand behind her short term liabilities – the US dollars. If, on the other hand, she was to tidy its deficit or even turn it into a surplus, this would imply a drain of international liquidity which would affect negatively the US as well. Given that gold reserves were not rising accordingly to back the US dollar and act as the final means of payment in the world market – that is, as world money – the problem had no solution (Triffin 1960). The system as it had unintentionally evolved, in short, made continuing US payments deficits both necessary and alarming (Yeager 1996).

The plans that tried to deal with this hot issue were focused on two aspects of it: first, on the fixed exchange rate between the US dollar and gold at $35 per ounce of fine gold and second, on the reform of the IMS so as to be based on credit money, but yet not a nationally issued; rather they examined the case whether a world bank could be set up to issue world money.

The first strand was definitely a dead end; there seemed no plausible way to float, or even alter once the rate – the dollar price of gold, or better, the golden price of the dollar – without undermining the foundations of the IMS. The reason mostly provided was that a shift in the rate would shake the credibility of the dollar, since such a shift could then reoccur. Another reason was that a shift in the rate would revalue the gold stock of the USSR.

As for the other strand, although many authors argued against an IMS based on gold, it can be considered that the first complete proposal was Keynes’, as it was formed during the negotiations that led to Bretton Woods. Essentially, Keynes argued there for the establishment of a World Central Bank, the International Clearing Union.

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16 “It was a mistake to see a deficit in America’s serving the world as a giant bank.” (Yeager 1976, p. 586)
17 The Chairman [of the Joint Economic Committee of the US Congress, GL]: Though you did not mention this [speaking to Triffin, GL], to raise the price of gold would enrich, I suppose, the Union of Soviet Socialist Republics and South Africa?” (Triffin 1960, p. 177)
(ICU). The latter would issue an international means of payment which would be legal tender for the world market, on the same principles that a national Central Bank functions. This world money – bancor – would be credit money, based on the creditworthiness of the state members of the ICU. In this plan, the ICU would transact only with national Central Banks, the latter related towards ICU analogically as the commercial banks do to the national Central Bank (Keynes 1980).

Nevertheless, Keynes plan could not apply due to the interrelation of powers between national bourgeoisies, as it was expressed through, and intermediated by, the relation of state powers. After all, the intention of the founders of the Bank for International Settlements, as early as in 1930, was that it should be a bank for central banks, especially of Europe and North America (Tew 1977). The member states could not act altogether as one world state through a collaborative process because there was no long run tendency to collaborate; rather, the tendency was towards antagonism, and any cooperation was expressing necessary compromises that should be made temporarily, reflecting some relative weakness – economic, political or ideological – of one side, or both.

This can be made clearer through a thought experiment. Keynes anticipated the case that a member state would withdraw from the Union not being able to stand for its liabilities. The other states would then be obliged to cover the liabilities of this member – as in the case of the default of a commercial bank in a national economy (Keynes 1980). Suppose that the member states would agree on that clause under the pressure of acquiring international means of payment to recover from WW II. Their signature would not constraint them to refuse in the future backing the default of a member state, if the provision of this backing would weaken their position at the time and if they were strong enough to oppose their interests to the international pressure. After all, the signature in the Stability and Growth Pact did not constraint member states of the European Union to violate it systematically.

Further, it is questionable under which criteria the monetary policy would be planned and for whose benefit. What would happen, for instance, during the recent crisis? Would the world Central Bank bail out the American and British banks, while spreading the burden to other members of the Bank that do not face the same problems or, at least find themselves in a different timing? Or is it implied that all the countries would be aligned, achieving convergence, and this state would coincide with the international contingency? Most probably, such a World Bank would reflect
the dominance of one or a few countries over the others, almost in the same way as it happens in our days and with much more restrictions.

In that sense, the proposed IMS wouldn’t have a lender of last resort. No one could feel certain in advance about what would happen in the eventuality of a crisis, as it is the case in a national economy, where default of the central bank means default of the state. If the answer is that the big imperialist states would carry the burden in such a contingency, then why should those countries accept to resign from all the benefits of issuing world money themselves, while keeping all the obligations?

Triffin went one step further, not only arguing that a world state is a precondition for a world central bank, but also that this state is needed for the given level of development of the capitalist economy, and in order to push the latter even more.

“We [the Western world, GL] have now resumed, at long last, the same evolution which erased the medieval borders of duchies, counties, and principalities to merge them into the national states of modern times. National states – at least all but the largest ones – are as obsolete today as the duchies, counties, and principalities of yesteryear. They will be merged some day into a world community, […]” (Triffin 1966, p. 95).

The world state would signify, as simple the issue can be put as possible, the abolition, or at least suppression of the national bourgeoisies and the establishment of a supranational one as well the downwards unification of the proletariat accompanied by the proletarianisation of huge masses of the world population. It is therefore a multi adversative process, which, at the end of the day cannot occur in the course of capitalism and definitely not through a charter act. It is not an issue that can be politically imposed if it isn’t incumbent upon the economic evolution18.

In his influential book of 1916, *Imperialism, the highest level of capitalism*, Lenin argued that capitalism cannot grow symmetrically. He called that property the law of asymmetric development. The law is based upon the pursuit of profit in the age of the monopolies. The latter, controlling directly or indirectly their national states, move towards splitting the world, and not merging it. This is a process of antagonism, where one is contesting against the position of the other and the outcome is a

18 “Similar limitations on any ideal pattern of international economic institutions are likely to remain with us as long as political and administrative difficulties make it utopian to contemplate a merger of national sovereignties into an effective world government.” (Triffin 1966, p. 87, emphasis added)
redistribution of economic power and market shares. It is a process that was climaxed with two world wars in the previous century.

In recent years, the extraction of profits from the South in favor of the North and from the developing countries in favor of the developed is a commonplace. Even in the interior of a peripheral union, like the European Union, this process is manifested. Unlike the need for political unification and integration of the markets, the opportunity on behalf of big enterprises to exploit those national differences by extracting more surplus value is dynamite to the foundation of the unification process.

What would there be, thus? We should better ask: what is that dollar cannot do without its gold backup, in the system that emerged after 1973? Which problems the world economy couldn’t anticipate, or found it hard to deal with, under a regime with no anchor, golden or other?
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