Currency wars and the contradictions of capitalism

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The currency conflicts that erupted last week between the US, China and Japan point to deep-going contradictions at the very heart of the world capitalist economy.

Disputes between the US and China over the dollar-renminbi rate have been fuelling international monetary tensions for some time. But last Wednesday the conflict acquired another dimension when the Japanese government intervened in currency markets. Spending more than $23 billion, Japanese monetary authorities pushed down the value of the yen by around 3 percent against the US dollar.

The significance of the intervention lay not just in its size but in the fact that the Japanese government acted unilaterally. This brought criticism from European authorities that “unilateral actions are not the way to deal with global imbalances” and condemnation from the US Senate Banking Committee chairman Chris Dodd that the intervention “broke international accords.” Significantly, however, the Obama administration, which views Japan as an ally in its conflict with China, did not comment.

The US-China tensions were again on display last week as US treasury secretary Timothy Geithner, testifying before Congress, demanded that China allow its currency to rise at a faster rate against the US dollar. The US administration, he said, was “examining the important question of what mix of tools, those available to the United States and multilateral approaches, might help the Chinese authorities to move more quickly.” As former Clinton Labor Secretary Robert Reich noted, this statement, when “translated,” meant: “We’re on the verge of threatening them with trade sanctions.” Other commentary also noted that the currency conflict signified that the world had moved closer to the type of trade war that characterised the 1930s.

The immediate source of the antagonisms is the drive by the major capitalist powers to counter the effects of stagnation in the world economy by expanding their exports. The Obama administration wants a lower US dollar to make American industry more competitive, but Chinese authorities fear that too rapid a rise in the renminbi will hit manufacturing firms operating on low profit margins leading to unemployment and rising social tensions. Japanese exporters maintain that they cannot operate profitably while the yen dollar rate is in the 80s and insist it must fall to around 95 to the US dollar. The European powers, especially Germany, where exports account for around 40 percent of GDP, want to maintain the value of the euro at around $1.30, rather than the level of $1.50 it hit last year.

While these conflicts are being fuelled by the immediate global economic situation, they have a deeper historical significance. They are one of the forms of the irresolvable contradiction at the very heart of the capitalist system: that between the global economy and the division of the world into rival nation-states.

Each capitalist nation has its own currency, backed by the power of the state within its own borders. But no currency is in and of itself world money. However in order for the capitalist system to function there must be an internationally-recognised means of payment.

Initially that role was played by gold and other precious metals. But with the expansion of the capitalist economy, especially from the latter half of the 19th century, the metal base of the monetary system became increasingly restrictive and had to be overcome. The rise of Great Britain as the dominant economic power provided the means by which it was achieved.

While gold remained the official base of the world monetary system, in practice the world economy increasingly operated on a sterling standard. Reflecting the power of the British economy and financial system, due in no small part to the massive resources drawn from India and other parts of the British Empire, the pound sterling functioned as world money.

However, the situation dramatically changed after World War I. Britain emerged from the war as a victor but it had suffered a massive economic decline relative to its rivals. In order to pay for the war, it had moved off the gold standard, meaning that sterling was no longer as good as gold.

The attempted restoration of the gold standard by the British government in 1925 collapsed in 1931 when, in the midst of a European banking crisis, sterling was devalued. For the rest of the decade the world economy remained mired in the Great Depression and the world market fractured into rival economic blocs, leading to the outbreak of war in 1939.

The Bretton Woods Agreement of 1944, under which the US dollar was tied to gold at the rate of $35 per ounce, was aimed at establishing a viable world monetary system without which the global economy would have rapidly returned to the conditions of the 1930s.

The agreement, in which the US dollar, by virtue of the overwhelming economic dominance of American capitalism, effectively functioned as world money, played a decisive role in restoring world trade and investment flows. However, the Bretton Woods system rested on a contradiction. The maintenance of international liquidity required an outflow of dollars from the US to the rest of the world. But this outflow undermined the relationship between the dollar and gold, as the dollars circulating in the world economy expanded way beyond the gold held by the US Treasury.

The dollar-gold gap steadily widened throughout the 1960s until US president Nixon declared on August 15, 1971 that henceforth the dollar could no longer be redeemed for gold. With the ending of the Bretton Woods system, the ability of the US dollar to continue to function as world money rested on the strength of the American economy and its financial markets. But that strength was being continuously undermined.

By the end of the 1980s, the US was no longer the world's leading creditor nation but had become its chief debtor, dependent on inflows of capital from the rest of the world. This inflow masked, to a certain extent, the internal rot and decay of the US financial system. But it periodically came to the surface in a series of crises, starting with the stockmarket crash in 1987, and continuing throughout the 1990s: the bond crisis of 1994, the meltdown of the hedge fund Long Term Capital Management in 1998 and the so-called "tech-wreck" of 2000-2001, culminating in the meltdown set off by the collapse of Lehman Brothers on September 15, 2008.

The ensuing global financial crisis and currency conflicts point to the intensification of the contradiction between world economy and the nation-state system. The global capitalist economy requires a stable reserve currency—world money—in order to be able to function. But the US dollar is increasingly incapable of playing that role. Nor is any other currency—neither the euro, the yen or the renminbi—able to take its place.

The growing lack of confidence in all paper currencies is reflected in the rising price of gold, which regularly reaches new records. But a return to the gold standard is not a viable solution either, as it would lead to a massive contraction of credit, plunging the world economy into a depression rivalling or exceeding that of the 1930s.

In the midst of the growing turmoil, the possibility has been canvassed of the major powers reaching some kind of accord, along the lines of the Plaza Agreement of 1985, which brought about an internationally-organised reduction in the value of the US dollar. But one only has to consider the differences between the situation in 1985 and today to see why such a project will not be realised. Twenty-five years ago, the US still exercised economic hegemony and the Atlantic economies formed the main centre of world growth. That is no longer the case: the US is in economic decline and the economic centre of gravity is moving rapidly to the East.

No doubt the currency crisis will take many twists and turns in the coming period. But the overall logic of the process is clear. The world economy will increasingly fracture into rival regional and currency blocs, once again raising the spectre of military conflict.

The only way to prevent this disaster is to fight for the program of socialist internationalism—the overthrow of the profit system and the nation-state system on which it is grounded and the establishment of a rationally planned world economy.

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