When the US defaulted: 40 years since the collapse of the Bretton Woods Agreement

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Much of the commentary on the significance of the Standard and Poor's downgrade of the US credit rating has dismissed the significance of this event on the grounds that the US would never default on its debt. But 40 years ago today the US did default when President Nixon went on Sunday night television to tell the world that America would no longer honour its commitment to redeem US dollars for gold.

This unilateral decision shattered the Bretton Woods Agreement of 1944 that had formed the basis for the revival of international trade and investment after World War II, providing a key foundation for the post-war capitalist boom.

The Bretton Woods Agreement was the outcome of several years of negotiations and discussions between the leading economic and financial figures in the United States and Britain. There was a broad understanding on both sides that unless the basis for a new international financial system were established, the post-war economy would rapidly return to the conditions of the 1930s, posing the threat of social revolution.

But there were sharp differences between the two sides. John Maynard Keynes, the leading British negotiator, who had made his name with his searing critique of the Versailles Treaty of 1919 that ended World War I, was anxious to maintain the economic position of Britain, while forced to recognise the overwhelming economic supremacy of the United States. Keynes proposed that an international currency, bancor, be established, administered by an International Clearing Union which would regulate trade.

This was rejected by the US administration and its chief negotiator Harry Dexter White. Having established its hegemony over its capitalist rivals, the US was not prepared to submit itself to the international regulation that Keynes's plan envisaged. However, while the US secured the establishment of the dollar as the preeminent global currency, it was forced to make a concession by guaranteeing that all dollars outside the US could be redeemed for gold at the rate of $35 per ounce. On the basis of the dollar-gold relationship, all major international currencies were tied to the dollar and thereby to each other at a fixed rate. Together with the push to establish free trade, fixed currency relations were aimed at preventing the destructive competitive currency devaluations that had erupted in the 1930s.

The Bretton Woods Agreement played a key role in reviving the world capitalist economy. But its very success saw the emergence of new contradictions.

The expansion of international trade and foreign investment (of which US capitalism was a major beneficiary) meant that there had to be a continuous outflow of dollars to finance growing international liquidity requirements. But this undermined the relationship between the dollar and gold. The dollars circulating in the world economy grew at a faster rate than the gold held by the United States that was supposed to back them. This problem began to emerge at the beginning of the 1960s—President Kennedy is said to have worried about nothing so much as the dollar-gold relationship—and deepened throughout the decade. The volume of dollars outside the US grew from $5 billion in 1951 to $38.5 billion in 1968, some $23 billion greater than the US gold reserves.

The US balance of payments (measuring the total inflow and outflow of finance) was in deficit due to US foreign investment and overseas government expenditures, especially on the Korean and Vietnam Wars. But it was still covered to some extent by a balance of trade surplus—the excess of US exports over imports. However when the trade balance shifted into the red at the beginning of the 1970s, reflecting a decline in the competitive position of the US in the world market, Nixon intervened.

The ending of the Bretton Woods system was not only a product of the relative decline of the US. It was also the expression of an irresolvable contradiction of the capitalist system—that between the growth of an increasingly integrated world economy and the division of the world into rival nation states.

Throughout the 1960s, successive American administrations had attempted to maintain the Bretton Woods system through the imposition of regulations restricting the flow of dollars. But they were continually thwarted by the growth of what became known as the euro-dollar market, comprising the dollars that circulated in the European financial system outside the control of any national government. Reflecting the growing frustration at the inability of even the most powerful national governments to bring this market under control, British Labour Prime Minister Harold Wilson regularly denounced the "gnomes of Zurich"—the Swiss bankers supposedly at its core.

While the US dollar remained the global reserve currency after August 1971, the new system of floating exchange rates brought increased instability to the global financial system. It was from this time that the rise of financial derivatives, which play such a crucial role in today's deepening economic and financial crisis, can be dated.

Derivatives, such as futures contracts, have existed for a long time. But after the collapse of the Bretton Woods system, the instability of currency and other financial markets coupled with the ever-closer integration of the world economy necessitated the development of new financial instruments that could insure against risk. Derivatives came into existence to meet that need, but soon underwent an explosive growth extending far beyond their origins.

In 1972, one year after the demise of Bretton Woods, a market in currency futures was launched in Chicago. The following year a formula was developed for pricing financial options and an options exchange was established. In 1975, the Chicago Board of Trade introduced the first interest rates futures contract. According to the Bank for International Settlements, in 1973 financial derivatives were virtually non-existent. In June 2008, on the eve of the Lehman meltdown, so-called over-the-counter agreements (OTCs) had a notional value of $683.7 trillion, or more than 10 times the value of world output.

The spectacular growth of derivatives over the past four decades underscores a process analysed by Marx in relation to credit. In the first stage, he noted, credit "furtively creeps in as the humble assistant of accumulation." But it ends up as an enormous social and financial mechanism. Likewise, derivatives first entered the scene as a servant of capital to protect it against risk, but ended up helping to create the greatest financial disaster in history.

The collapse of the Bretton Woods system and the turbulence it produced played a significant role in fuelling the explosive social and class struggles of the early 1970s. However, the working class was blocked and defeated by the betrayals of its own leadership.

But those defeats did not resolve the contradictions of the global capitalist economy which tore the Bretton Woods system apart. Indeed, they have intensified. The historic decline of the United States continued and is now the most destabilising factor in world economics and politics, while the contradiction between world economy and the nation-state system has erupted in the form of the breakdown of the international financial system.

This means the emergence of revolutionary struggles, on a scale and scope far beyond those of four decades ago. The lessons of past defeats must be drawn and the crisis of working class leadership resolved. Above all this means building the International Committee of the Fourth International as the world party of socialist revolution.

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