

From 'Static' Gold to the Floating Dollar^{*}

Franklin Serrano^{**}

I. Introduction

In this paper we discuss some essential features of the balance of payments position of the country which issues the key currency under different international monetary standards. The analysis takes a Sraffian standpoint, where the monetary rate of interest of the central country is seen as an independent policy variable, institutionally determined (Pivetti (1991, 2001), Serrano(1993, 2002)). We start in section II by making a preliminary discussion of the balance of payments position of the central country in abstract, within a simplified scheme in the context of an international monetary standard referred to gold. In the subsequent sections we apply the results of our scheme to the historical evolution of the international monetary system, criticising along the way some curiously “monetarist” hypotheses (of either “national” or “global” type) which are implicit or explicit in many well known, and often otherwise critical, analyses of the subject. We shall criticize the idea that the gold-sterling standard was regulated through international movements of gold and also the alternative view according to which the pace of growth of the world economy was ultimately dependent on the availability of gold (section III). In what regards to the gold-dollar standard, we shall also take issue against the well known “Triffin Dilemma” (section IV). This brief and schematic analysis of the theories and experiences of the earlier international monetary standards shall allow us to reach, towards the end of the paper (section V), the prime aim of this work which is that of providing a simple but sufficiently precise characterisation of the current international monetary standard, that we shall call the “floating dollar standard” (see Medeiros & Serrano (1999,2003)).

II. The Adjustment without Movements of Gold

Our central hypothesis is the following: the country that issues the key currency in a gold-referred standard can in fact settle its balance of payments in its own national currency. This means that this country to have chronic global deficits in the balance of payments of any magnitude.

Nevertheless, this does not mean that this country should not worry about its external position. There are two things that this country should not allow to occur: a) chronic deficits in the current account; and b) changes in the official price of gold in terms of the local currency (the parity) which must remain fixed in nominal terms for the longest possible length of time (in other words, the central country should not take the initiative of devaluing its own currency relative to gold and the other currencies).

^{**} Instituto de Economia, Universidade Federal do Rio de Janeiro, Brazil (franklin.s@openlink.com.br).

In a closed economy the State does not need to worry about the risk of default regarding its internal debt because the latter can **always** be settled with currency it issues. Moreover, the fact that the State is the zero risk internal debtor gives it the power of **exogenously** determining the basic interest rate for loans denominated in the currency it issues.¹

By analogy, in a gold-referred international monetary system, the economy of the central country which issues the internationally accepted currency and observes the two above mentioned conditions (namely: a) avoiding current account deficits ; and b) keeping the nominal parity fixed) has zero “sovereign” risk of default on its external debt, for this country can **always** settle it in its own currency. This zero risk condition by its turn also makes the interest rate fixed **exogenously** by the monetary authorities of the central country become the international economy's basic interest rate .

Let us see how such a system would operate, beginning with the question of the global deficit of the balance of payments. We may write the balance of payments of the central country as follows. The global result of the balance of payments of this country will be defined as equal to the net variation of the stock of gold of this country (G), added to the variation of the external short term assets (STC) (following Kindleberger(1987))². Then we are going to use the following equation of the balance of payments of this country:

$$G + STC = X - M + R - LTC$$

where $X-M$ is the overall trade balance (note that we are including the non-factor services or "invisible trade" in the trade balance), R is the factor services balance, and LTC is the balance of the flows of long term capital (including both lending and foreign direct investment).

Let us assume that the hypothetical central country has a chronic deficit in the commodities trade account, which is nevertheless fully compensated by the surplus both of the non-factors service and of the factors service accounts. In this case the current account balance ($X-M+R$) will be either zero or positive. The important condition here is that no chronic current account happens, to prevent the central country from losing gold – accumulating gold claims through current account surpluses is not a problem.

¹This view of the rate of interest determined exogenously by the monetary authorities follows the Sraffian approach (see Pivetti(1991, 2001)). Note that this exogeneity of the rate of interest does not require any restrictive hypothesis either on the “supply” or on the “demand” for money, and neither on the type of policy followed by the central banks. In this approach bank credit (and as a consequence the aggregate M1) is seen as evidently endogenous (for the banks cannot be forced to lend) but meanwhile the high powered monetary base may be partially exogenous due to fiscal or balance of payments reasons (the money “multiplier” is, from this standpoint , a mere *ex-post* ratio between the above two aggregates, Serrano(2002)) . Fortunately, in recent years more and more Post-Keynesian authors have abandoned the theory of the interest rate based on supply and demand for money and got closer to the above view, either via “horizontalist” (endogenist) arguments or more directly via the recent rediscovery (see Randall Wray (1999)) of the “Chartalist” approach of Knapp and Abba Lerner who emphasized that money was " a creature of the State".

²Note that in this equation a negative STC indicates inflow of short term capital while a positive STC indicates an outflow of short term capital. By the same token a negative LTC indicates inflow of long term capital while positive LTC indicates outflow of long term capital.

Let us suppose also that that this country builds many railways abroad and lends money to the other nation States, that is, that LTC is positive and reasonably large.

This means that the has a global deficit in the balance of payments, but since it is the central country whose currency is accepted for international payments, this deficit does not generate any problem. The reason is simple. The other countries that collectively will have a surplus in their balance of payments will not accumulate gold that pays no interest but, instead, they will invest them in high liquidity assets in the central country itself. This means that, for the central country, every deficit on BP caused by the large positive LTC will be fully compensated by a flow of short term borrowing (a negative STC), which means that the variation of reserves of gold is exactly equal to zero (in fact if we defined the result of the balance of payments merely as movements of gold, the balance of payments would be, in this case, always in equilibrium).

It is possible to object here that nothing guarantees that all the potential outflow of gold is going to be automatically counterbalanced by an inflow of short term capital (negative STC) of an identical value. This is true but, as it has been said in the age of the gold-sterling standard, “six percent will bring gold from the moon”. That is, we must remember that it is the central country that autonomously fixes the short term rate of interest and can manage it as necessary in order to make the balance of variation of gold be around zero (or positive).

Note that in the abstract case we are analyzing, successive deficits in the balance of payments of the central country will be accompanied by equilibrium in the current account. Therefore, “below the line”, the variation of the net external liabilities of the central country is zero, that is, the absolute value of STC is equal to that of LTC . Note that these are the ideal conditions for the operation of a gold standard, from the point of view of the central country. The central country stimulates effective demand in the rest of the world with its trade deficit, and at the same time, by investing long and borrowing short term, provides liquidity for the other economies in the system (Minsky (1994)).

Within the scheme we are using both the central economy and the others can grow continuously and, in the limit, even without any increase in the production of gold or any movement in the stock of gold whatsoever. In other words the “monetary base” may well be constant.

If we want to reason in these terms we may also note that the “monetary multiplier” of gold is equal to one (in the extent that banks do not produce gold), but then because of the continuous increase of the values of both the LTC and STC (i.e., of the gross capital flows) the “velocity of circulation” of high powered money(gold) increases continuously.³

³ For the sake of the argument we could apply the same reasoning in terms of the “supply” of fiat money of the central country (instead of gold). In this case, if we assume that the monetary base of this country is constant and that their banks create money in the orthodox textbook way from a “monetary multiplier” which is also constant, the stock of $M1$ of this country will not increase. Even in this hypothetical case, if the deficit in the balance of payments caused by a positive LTC is compensated by a negative STC there will be no shortage of international liquidity, because the international “velocity of circulation” of this fiat currency is going to increase continuously.

However, as long as the central bank of the central country maintains the full liquidity of its national public debt bonds, there will be no shortage of liquidity in the system (Kindleberger (1987)).

Thus, regarding the movements of gold, it is possible to argue exactly the opposite of the conventional view. The system actually only works well (for the interests of the central country) while gold does not start to flow out of the central country. This is why it is not recommended that the central country runs deficits in its current account persistently, for it would mean a situation in which its net external liabilities in fact increase period after period. That would result in actual gold (or rights to gold) changing hands.

It is easier to see this if we rewrite the result of the balance of payments with the current account on one side ("above the line", i.e., revenues and expenditures) and its financing on the other side ("below the line").

In this case we have:

$$X-M+R=(G+STC)+LTC$$

If the central country runs deficits in the current account, the right hand side (the variation of the external net liabilities) will turn out to be necessarily negative, for in this case even if the physical movement of gold is avoided making G equal to zero, this can only happen at the cost of the absolute value of STC being larger than that of LTC , i.e., at the cost of the central country being borrowing short **more** than it is investing long. Thus its net external liabilities, in terms of in gold, will be increasing.

As we mentioned above, the other limit to the freedom of the central country is the fact that the latter may not take the initiative of devaluating its currency. This is because what allows the smooth financing of deficits in the balance of payments of the central country is the full convertibility between its currency and gold. If the value of this currency measured in gold starts to float, then it is not true anymore that this currency is "as good as gold" and it is quite probable that the other countries will start asking for external payments directly in gold in the place of in financial assets denominated in the key currency.

III The Gold-Sterling Standard

III.1 The Gold-Sterling Standard and its Decline

Let us adopt the following chronology of international monetary systems:

1. The Gold-Sterling Standard, from 1819 to 1914;
2. The attempt to return to this standard from the end of the First World War until the 30's;
3. The Gold-Dollar Standard, from just after the Second World War until 1971;

4. The period of crisis up to 1979.
5. The floating dollar standard from 1980 until now.

We can, using this chronology of monetary systems, interpret the various periods according to our analytical scheme.⁴ The first period corresponds to the gold-sterling standard. Within this period, in general, England sustains the parity of its currency in relation to gold, tends to have a merchandise trade deficit, has no deficits in the current account (during this period England experiences surpluses in this account – with deficits on it starting to appear only from 1914) and finances all of its the balance of payments deficits caused by the outflow of long term capital, by receiving short term inflows from the rest of the world.

Within this system, it is important to stress that because of the protectionism, of the gains of productivity of the other countries which industrialised later and also of the fixed nominal sterling exchange rate, Great Britain had increasing deficits in merchandise trade. Those were compensated by the non-factors services balance (insurances, freight, etc.), by the big surplus in merchandise trade *vis a vis* the colonies (specially in regard to India) and by the net income received from its investments abroad (DeCecco (1984)).

Within the second period, which begins at the end of the First World War, we see that the system does not work adequately anymore. On one hand, the former central country, England, incurs in current account deficits (it even loses the bilateral merchandise trade surplus with India). The post war attempt to return to convertibility is done using the old parity, despite of the differential inflation occurred during the First War and of the change of parity of many other countries. This return to the old parity was heavily criticised by Keynes but, from the point of view of the financial interests (as Hicks (1989) reminded us) it made sense, to keep the idea that the sterling was in fact still “as good as gold”.

As it is well known, this return is a failure, given the loss of competitiveness of Britain the changes in the international situation thanks to the accumulated external current account deficits during wartime. Gold, during the 20's and 30's, kept flowing inexorably towards the USA.

However, American economic policy during that period was operated in a way which prevented the U.S. from performing the role played by Britain in the preceding period. In the interwar period, the United States obtains surpluses both on the current account (and in its trade balance) and also on the capital account draining gold from the rest of the world. To worsen things in the 30's the USA increased their tariffs, raised their interest rates and later even devalued their exchange rate, helping to push the world into the Great Depression.

III. 2 The National Monetarism from Hume to Eichengreen

⁴For an analysis of the center-periphery relations using this chronology of international monetary systems see Medeiros e Serrano (1999).

In the orthodox neoclassical view the gold-sterling standard worked automatically and brought the external equilibrium of all the countries through international movements of gold, which by leaving the deficit countries caused deflation and competitive gains, and by entering the surplus countries caused inflation and loss of external competitiveness *a la* Hume(1752) (for a New Classical version see Barro(1979)). From this perspective its end was the result of political and protectionist interferences that led to the inobservance of the supposed “rules of the game” (flexibility of prices and wages, absence of interventions sterilising the impact of the result of the balance of payments on the domestic monetary base, absence of custom barriers, etc.) after the First World War.

Note in particular the recent analysis of Eichengreen (1996), who in a quite monetarist perspective attributes the collapse of the gold-sterling standard to the lack of downward flexibility of nominal wages in the central countries. Curiously enough Eichengreen(1996) tries to disguise a bit the limitations of his economic analysis and in order to do that he uses the well known and interesting political analysis of the period made by Karl Polanyi(1944) which he turns into a “sociological” explanation of the “nominal rigidity of wages”. In reality, contrary to Eichengreen (1996) the the downward flexibility of nominal wages and prices seems to have been *excessive* and increased , since nominal interest rates did not fall nearly as much , the real rates of interest and the burden of debts, leading to waves of bankruptcies , debt deflation etc., as noted by so many analysts at the time , including, of course, Keynes.⁵

III.3 The Discreet “Global Monetarism” of Robert Triffin

According to a different and well know interpretation by Robert Triffin (1972) the system in reality never operated following the “rules of the game” supposed by the followers of David Hume. Triffin shows the fundamental relevance of the flows of capital which made viable the maintenance of trade balance disequilibria for decades (like that of Britain, for instance) and argues that the various countries instead of correcting deficits and surpluses with deflations, inflations and large movements of gold, had balance of payments disequilibria which were relatively small and tended to follow together the path of the international trade cycle (in terms of interest rates, of prices and levels of activity) dictated by the expansion of international liquidity. In his point of view, Triffin argues that the fixed exchange rate regime imposed the constraint to the countries in the core of the system that they should avoid growing either much faster or much slower than what was allowed by their balance of payments situation , averting thus the necessity of adjustments which involved drastic changes in the levels of prices and wages (or exchange rates)⁶ Triffin shows also that in all core countries, the development of commercial banks increased substantially over time the domestic use of fiat. He attributes the freeing of gold reserves which progressively left the domestic circulation and reinforced the reserves of the respective central banks to this increased domestic use of fiat money.

⁵ Belluzzo(1997) does not seem to notice these deficiencies in Eichengreen's analysis.

⁶However , in the countries of periphery countries these quantity adjustments were not enough and more drastic adjustments of prices and exchange rates were unavoidable and aggravated the instability of these economies.

Still according to Triffin (1972), the expansion of the international liquidity before the First World War was satisfactory (for the countries of the core) because the quantity of gold possessed by the central banks increased enough to meet the needs derived from the growth of the international trade, through the combination of larger discoveries of gold and the withdrawal of the latter from the domestic circulation (either silver or fiat money were substituted for gold, according to the time and country under consideration) and also, in a quite smaller scale, by the acceptance of national currencies (in particular pounds sterling) as a component part of the core countries international reserves.

Following this analysis, Triffin considers that the failure of the attempts of returning to the gold standard after the First World War had a structural reason, which was the inadequacy of the growth and distribution of the international reserves of gold, reserves that, with the by then almost complete extinction of the domestic circulation of gold, could only grow additionally from increases in the world production of gold.

This interpretation, though evidently vastly superior to the orthodox neoclassical one, suffers however from two basic and inter-related deficiencies. The first one is the assumption that **all** countries of the core submit themselves equally to the discipline imposed by the gold standard and adjusted their domestic expansions to the balance of payments constraint. Following Triffin's argument, Britain seemed to be in the same footing as the other core countries regarding its (lack of) autonomy in terms of economic policy.

The second problem regards the idea that the **global** rhythm of expansion depended on the collective creation of international reserves, i.e., on the increase of the quantity of gold collectively available to the central banks.

In respect of the first point it seems to us that, in fact, the economic policies and the evolution of the core economies which took part in the gold standard have been forced to follow, to a certain extent, a common cyclical rhythm, but that this rhythm was given **asymmetrically** by the movement of the **British** economy, which led the world by means of the determination of the basic international interest rate, by the impulses of effective demand through its external trade, and by the fundamental role of British capital flows for the financing of world trade.

The reason behind this asymmetry is the fact that the gold standard was, in reality, a gold-sterling standard where the international currency in practice was the pound sterling. The rhythm of expansion of trade and international liquidity therefore was not determined by the increase of the availability of gold, but instead by the expansion of the British economy and of the international financial system based on sterling (see Medeiros e Serrano (1999)). Apparently Triffin does not notice all this for two main reasons. First, because he seems to think that the global result of the balance of payments of any country is given only by the variation of gold (G), forgetting the central role (both to Britain and to the other countries) of the financial assets denominated in sterling (STC), which he sees as having had a minor contribution to the formation of international reserves in that period. Triffin probably thinks along this lines because indeed the **net** effect of capital flows (LTC -STC) was small even though the **gross** flows of STC were becoming larger and larger. It seems that Triffin reads the

equation of the balance of payments was (both for Britain and the other core countries) as:

$$G = X - M + R - LTC - STC$$

Moreover, Triffin considers that the expansion of international trade requires a proportionate increase in the volume of gold reserves.

Thus in his analysis Triffin (1972) does not only consider gold as the “monetary base” of the system, and that for the world economy the “monetary multiplier” of gold is always equal to unity (for the banks do not create gold), but considers also that the velocity of circulation is always constant or at least highly stable. Only reasoning in this way it becomes logically possible to say that it is the exogenous increase of the international reserves that determines the growth of the level of activity of the international economy.

These implicit hypotheses are all very close to what has come to be known as "global monetarism" in its version with non-flexible prices (see Johnson *et alii* (1976)) and are obviously very problematic in both empirical and theoretical terms.

As we saw on section II above, there is no reason for those hypotheses to be confirmed. For a given British rate of interest, a given rhythm of expansion of credit, of the effective demand and of world trade, the ratio between short term assets in sterling and gold would be increasing all the time. If we wish we may say then that the “velocity of circulation” of gold increases continuously.

This being so, it seems clear then that the end of the gold-sterling standard and the failure of the attempts towards its return were linked to the First World War and its geopolitical consequences mentioned in the beginning of the section (see Medeiros and Serrano (1999)) and not to the physical limits to the adequate expansion of the supply of gold, as argued by Triffin.

IV The Gold-Dollar Standard

IV.1 The Gold-Dollar Standard and the “Triffin’s Dilemma”

After the Second World War we have the period of the Bretton Woods Gold-Dollar standard of. Within this period, which lasts until 1971, the official price of gold in dollar is kept constant.

In the beginning of that period the USA has positive trade and current account balances, but the Cold War commitments makes the country, via foreign aid, loans and foreign direct investment, have increasing deficits in the balance of payments. Over time, with the reconstruction of the other core capitalist countries (stimulated and financed by the US), the trade and current account surpluses of USA were continuously reduced until they both become negative in 1971.

It is within the context of this gold-dollar standard that comes to light the debate on the so-called “Triffin’s Dilemma”. The argument from Triffin (1969, 1972) is that the international monetary system with convertibility between dollar and gold suffered from

a basic inconsistency. As we saw above, according to Triffin, under any international monetary system the growth of world trade requires the increase of the international reserves. In his point of view, the increase of the supply of gold showed itself to be completely inadequate to these purposes since the interwar period. Thus the only way out was that the other countries accumulated international reserves not in gold but in the key currency itself (the dollar and in a much smaller and decreasing scale sterling). This on its turn could only happen through global deficits on the balance of payments of the United States. However, and now the contradiction appears, the more the central country accumulates successive deficits on the balance of payments financed through its own currency, the larger will tend to be the ratio between the quantity of the key currency in circulation in the world economy and the gold reserves of the central country.

If the process goes on for a long time, inescapably the lack of backing in gold of the key currency will become clearer and clearer and the maintenance of convertibility will become more and more problematic. Thus the “dilemma” would come from the contradiction between two facts. On one hand, if the central country has persistent deficits the convertibility and survival of the system will be threatened. But if, on the other hand, the central country avoids deficits in the balance of payments in order to keep the key currency with a reasonable gold backing, world trade will not be able to grow adequately for a chronic shortage of international liquidity will arise.

From the analysis of this “dilemma” Triffin (1960) has foreseen that the gold-dollar Standard was bound to go into crisis and wished that it could be replaced by a reserve currency that was truly international and which could not be the national currency of any country.

Because the system in fact ceased to exist in 1971, perhaps the most accepted interpretation for its end is the combination of Triffin’s Dilemma, creating the fragility of the gold-dollar parity, with the uncontrolled out of control increase in credit within the Eurodollar circuit from the end of the 60’s, which is said to have increased even more the quantity of dollars circulating in world, reducing additionally the backing in gold of the key currency, thereby aggravating the situation (Parboni (1984)). The speculative movements of the de-regulated financial capital, according to this view, have forced the USA to abandon the convertibility.

Note however that within our analytical scheme presented in section II above, the “Triffin Dilemma” does not occur, despite the successive global deficits in the balance of payments of the central country and the continuous growth of trade and international finance. Besides, the convertibility of the key currency into gold is not threatened since, despite the deficits in the balance of payments, gold does not move (and does change hands either).

The problem with the argument of Triffin is that, as pointed out by Kindleberger in the 60’s (see Kindleberger (1987)), even though the international settlements are not made directly in gold, implicitly Triffin makes the arbitrary and monetarist hypothesis that the “velocity of circulation of gold” has to be constant. Thus for the convertibility to be sustained there must be some proportionality between the quantity of gold and of short term assets denominated in the key currency. Triffin simply ignores completely that the

gross flows of international capitals can make the “velocity of circulation” of gold increase without limit.

This hypothesis of “constant velocity” of gold, is easily refuted by the observation of more than a century of financial deepening all around the world. Without that hypothesis, however, the “Triffin Dilemma” simply disappears.⁷

IV.2 The “Exorbitant Privilege”

The analysis in the terms of “Triffin’s Dilemma” has been on the centre of the discussion, during the 60’s, about what the french President Charles de Gaulle named the “Exorbitant Privilege” of the USA who could finance their deficits of the balance of payments by issuing their own currency without gold backing and therefore benefiting themselves from international *seigniorage* gains. Following Triffin’s analysis this gain would be measured exactly by the size of the deficit in the American balance of payments, which would be identical to the issue of international money by the USA.

Other authors questioned partially this measure because (at least from the end of the 60’s) with the growth of the offshore circuit of Eurodollar, the international banks also were seen as a source of dollars issued to the international economy. Then the deficit on the American balance of payments was just an increase of the international “monetary base”, which was “multiplied” by the international banks (by the way without much control from the American authorities), creating the international “money supply”. In this case the gain from international *seigniorage* would be divided between the USA and the international banks (see, for instance, Parboni (1984)).

The official position of the American government in face of this controversy with its allies has been entirely based upon the analysis of Kindleberger⁸ (see Solomon (1982)). The American argument was that the question of the *seigniorage* itself was not very important for in practice the central banks did not have as reserves dollars in cash as a counterpart to the American deficits in balance of payments. These central banks held their reserves in high liquidity American federal bonds.

As these bonds paid “market rates of interest”, according to Kindleberger(1987) the American government did not get any *seigniorage* gain. As the USA provided international liquidity lending long and borrowing short the single possibility of gain that Kindleberger could see was derived from an eventual difference between the short term and long term, which were also seen as “market determined” and not very high.

Thus, according to Kindleberger the USA simply supplied a service (international liquidity) to the international economy and received a “market” remuneration for this. In this way the USA behaved as the “commercial bank” to the world.

⁷Despite of these serious deficiencies “Triffin’s Dilemma” and the interpretation with a global monetarist flavor of the crisis of the gold-dollar standard became quite popular even amongst 'critical' economists such as Parboni (1981), Teixeira (1994, 1999) and Arrighi (1996).

⁸His original paper, published at that time on the magazine The Economist, is reprinted in Kindleberger (2000).

There was then, no “Exorbitant Privilege”, but only a division of labour between the USA and the other countries.

As a matter of fact, Solomon(1982) and Kindleberger(1987), were quite right on the question of *seigniorage* being not crucial because the other central banks evidently do not retain large amounts of dollar in cash. The analysis of the critics has exactly the same “global monetarist” deficiencies of the discussion of the so-called “Triffin’s Dilemma”.

However, in contradistinction to what Kindleberger, Solomon and the American government argued, in fact issuing the international currency gives the USA a privilege much bigger than, or more “exorbitant”, than the *seigniorage* gains calculated *a lá* Triffin.

The USA has not in fact been the *commercial* bank of the world paying “market” interest rates on its external short run liabilities. The correct analogy is that the USA, when controlling the issuing of international money, plays the role of the *central* bank of the world.

The actual privilege of the USA within the gold-dollar standard was identical to that of Britain within the gold-sterling standard, i.e., the country has no global constraint on the balance of payments and besides its monetary authority determines unilaterally the basic world interest rate. It was quite clear that the USA did not intend to loose this privilege.

IV.3 The Nixon Dilemma

Along the decade of 60 it becomes clear for the American government that a realignment of exchange rate becomes necessary to slow down the comparative decline of the competitiveness of the USA.

Nevertheless, the devaluation of dollar via increases in the price of dollar in gold would bring in the risk of a rush to gold. With it, would come the threat of a reintroduction of the balance of payments constraint for the American economy, to the extent that international settlements would start to be made directly in gold instead of in dollar.

It is important to stress, as Solomon (1982) points out, that countries like the Soviet Union, being the biggest producer (together with South Africa, whose regime was “supported” by the USA), would gain a lot from an increase of the importance of gold in the world economy. And that France had been pressuring so much towards reforms in the system that could amplify the role of gold because of being historically a country that retained a relatively large proportion of its external reserves in gold. Surely it was not part of the interest of the national American State in the heat of Cold War to reinforce the relative power of these countries in particular.

During this period, there were also several proposals of reform made by American allies aiming at the creation of a truly international currency by means of the introduction of the so-called special drawing rights (SDR) which was supposed to be the basis for a new truly international currency. The USA also vetoed all proposals of

reform towards a truly international currency because although they did not carry the additional disadvantages of giving power to the countries who produced gold, if implemented they would also reintroduce the balance of payments constraint to the American economy, what was considered as unacceptable by the American government.

We may call this situation “the Nixon Dilemma”: the American government wished, at the same time, to devalue the dollar and not to jeopardise the role of dollar as international currency.

The American partners refused the proposal from the USA of a co-ordinated movement of appreciation of the currencies of the other countries (that should simultaneously reduce the official price of gold in their respective currencies by the same proportion). Besides, these countries have kept insisting on proposals of reform that would diminish the importance of the dollar in the international economy (improving the role of gold and/or of the Special Drawing Rights).

Within this context, the solution found by the USA to this dilemma was to unilaterally decree the inconvertibility of dollar on gold in 1971, as a preparation to the initiative of devaluing of the dollar, which begins in 1973 (Parboni (1984)).

V. The Floating Dollar Standard

The American decision of dismantling the Bretton Woods system brought the capitalist world economy to a period of great turbulence.

The new situation of inconvertibility and flexibility of exchange rates of the core countries generated large speculative waves, given a context in which effective demand and the international liquidity was growing, pushed both by the growth of the American economy and by the expansion of the offshore circuit of Eurodollar.

The worsening of rivalries between capitalist States and the complex geopolitical situation of the 1970's in the context of the Cold War naturally contributed to this systemic instability.

Moreover, to the extent that the American nominal interest rates were kept relatively low to operate the devaluation of dollar, a huge wave of speculation with commodities evolved that, combined with the worsening of the distributive conflicts and the challenge to American leadership, culminated with the two oil shocks, leading to an inflationary explosion never seen in peacetime in the core countries (Biasco (1979)).

In the end of 1979 there comes a new and decisive change in American monetary policy with the Paul Volcker shock interest rates shock. Interest rates reach unprecedented levels and are accompanied by a wave of financial innovations and deregulation measures that, since then, have been spreading all over the world.

This restrictive policy engenders a world-wide recession in which the prices of non-oil commodities fall drastically and the international inflation slows down gradually. The

USA since then progressively resumes the control of the international monetary-financial system (Tavares (1985)). The other core countries, finally convinced of the futility of questioning the centrality of dollar within the new system, start to accept a new international monetary system, the floating dollar standard.

Within this new standard the dollar is still the world currency. But now at last free from the two restrictions that both the gold-sterling, and the gold-dollar, imposed upon the countries that issued the key currency in the past.

Within the floating dollar standard the USA can incur in deficits in the balance of payments and finance them easily with assets denominated in their own currency, like in the other monetary standards discussed above. Furthermore, the absence of convertibility to gold gives dollar the freedom to vary its parity in relation to the currencies of other countries following their convenience, through movements of the American interest rate. This is true both for appreciating and for devaluing the dollar. In the latter case there is no reason to worry about a rush to gold anymore, because the new dollar standard is entirely inconvertible, based on the premise that one dollar “is as good as one dollar”, premise anchored on the power of the American State and economy within the uni-polar world of the post-Cold War period. As the dollar is the international means of payment and the unit of account in the contracts and in the prices of the international markets, it naturally becomes also the main store of value.

Fluctuations on the parity of dollar *vis a vis* other currencies have large negative effects in the countries which issue the other currencies and then either loose competitiveness when they appreciate, what worsens their external constraint, or suffer inflationary pressures when they devalue in relation to the dollar.

The USA looses competitiveness when the dollar appreciates but has no external constraint and can let their current account deficit grow with no limit.

On the other hand, when the dollar devalues the direct inflationary effect in the U.S. is minimal because the majority of international markets for homogeneous commodities and oil has prices that are set in dollars.⁹

The freedom to make the dollar float is thus one of the advantages of the floating dollar standard, under which USA does not need to loose real competitiveness in the name of maintaining their financial and monetary prominence.

The biggest advantage for the USA that comes from the absence of convertibility on gold is the plain elimination of their external constraint. Now, the USA can incur in permanent deficits on the current account without any concern about the fact that their net external liabilities may be increasing, for these “external” liabilities are denominated in the American currency and not convertible on anything else.

⁹In a recent paper Schulmeister(2000), one of the few authors that following Kindleberger grasps very well various aspects of the nature of the current flexible dollar standard, seems to overestimate very much the direct inflationary effect of a dollar devaluation and ends up appealing to a somewhat *ad-hoc* explanation (the loss of bargaining power of OPEC) to explain why the devaluation of the dollar during the period 1985-95 came together with a fall instead of a rise of American and world inflation.

The floating dollar standard, which Nixon and Kissinger had tried to introduce in the 70's and that finally became unquestioned since the 80's, allows the USA to incur in permanent current account deficits. In terms of our equation, the term G does not exist anymore and all the excess of absolute value of STC by LTC when a current account deficit exists means an increase of reserves of the other countries - that, by necessity, if they want to take part into the international monetary economy where the U.S. is the accepted means of payment, have to accept accumulating bonds in dollar (in general the American federal debt itself).

This means that now the USA does not have to vary its interest rate to attract capital and protect its foreign reserves. In fact, now the financing of the current account deficit of the U.S. is completely automatic at any given interest rate. There is no need to change American interest rates to attract gold or to protect the foreign reserves. The U.S. is completely free to set its interest rates according to their national objectives and gold can "stay in the moon".¹⁰

In his last book Hicks (1989) realised that the USA, from the beginning of the 80's had taken to them the duty of making the dollar the international currency and therefore correctly (according to him) started to have a "passive" behaviour regarding their balance of payments.

Nevertheless, Hicks asks himself if this role can be played adequately by a "weak" currency like the dollar. With "weak" Hicks means only that it is the currency of a country that shows a tendency to have chronic deficits in the current account. The answer to this question seems to be affirmative¹¹, since the American victory on the Cold War guaranteed the success of de-monetisation of gold and the reduction of the capability of objecting to the American leadership by the other capitalist national States.¹²

¹⁰ This is why Mr. O'Neill the Treasury Secretary of Pres. George W. Bush has often declared to the press that for him the current account deficit is a "meaningless concept" and that he "only talks about it because others do".

¹¹ Belluzzo (1999) seems to still have doubts about the answer and fears a possible run from the dollar. However, to the extent that gold has been de-monetised successfully by the USA, it seems clear that simply there is nowhere to run. The dollar is now the "fiat money" of the international markets.

¹² Recently Mckinnon(2001, 2002), also starting from the analysis of Kindleberger, realized with clarity the nature of the flexible dollar Standard, in an analysis that comes quite close to ours. The single more serious objection to his empirical works on this field is that this author considers the predominance of the dollar as the result initially of a "historical accident" in the immediate postwar period which was reinforced over time by the fact that the use of a single currency as a standard by the international economy facilitates trade very much (see in particular Mckinnon(2002)). However, it is a fact that the elimination of the possibility of balance of payments constraint for the USA has been the explicit aim of the policy of the American State over the whole post war period.

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