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Power Relations and American Macroeconomic Policy, from Bretton Woods to the Floating Dollar Standard*.

Introduction

The purpose of the present work is to try to show the strategic importance of the policy of defending the international position of the U.S. dollar and also of the general orientation of American macroeconomic policies to: 1) the victory of the capitalist side in the Cold War ; 2) the subsequent reestablishment e increase of the bargaining power of the property owning classes relative to the working class in the U.S.A. and finally 3) to the consolidation of the leadership of the American State over the other Nation States, that happened during the 1980s.

The other central element to the success of the American State and of capitalism, which perhaps was the most important, has been the development of the scientific-industrial-military complex of the U.S.A., which sustained American military and technological leadership- as shown by Medeiros (2005a, in this volume) . This factor will not be treated in this article apart from its macroeconomic impact on effective demand.

This paper is quite different from most others on these topics in two main aspects. First , this work is explicitly based, both at the theoretical level and in terms of historical interpretation, in the modern Classical Surplus approach which is being developed by the followers of Piero Sraffa (in particular Pierangelo Gategnani, Massimo Pivetti and Antonella Stirati).

In this approach, the distribution of income, relative prices and inflation are strongly influenced by political and institutional factors while the growth of the economy depends on the evolution of effective demand. The latter, by its turn, depends directly on the course of macroeconomic policies (fiscal, monetary, exchange rate, and income policies) of the State.[1]

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[1] This approach , that returns to the long tradition of the "objective theory of value" which dates back to William Petty in the XVIIth century has, in particular, the advantage of being based entirely in conflicts , techniques and institutions that are objectively observable in concretely specified historical situations (Medeiros, 2001 e Aspromourgos, 1996) and, therefore does not require that there should exist inevitable and invisible "immanent

A second important difference between this work and many others, comes from the fact that, in our view, the importance and the power of the American economy has been drastically underestimated in the critical literature, both in the period of the "Golden Age" and specially after the reestablishment of uncontested American leadership in the nineteen eighties. In the more recent period, the view of "American economic decadence", that is , the idea that the U.S. economy is inherently fragile financially and ever more "dependent of the rest of the world" and thus always on the brink of a major crisis is getting more and more popular among critical economists. I think that a reinterpretation of the broad evolution of American macroeconomic policy over the post war period may be useful to question this view by showing how much the U.S. State has consciously tried (and mostly succeeded) to keep the system under reasonable control. In reality, it seems that it is the rest of the world that is getting ever more dependent on the market, the currency and the economic policy decisions of the U.S., decisions often taken entirely on the basis of American domestic priorities and concerns.

This rather long paper is divided in two parts. The first part examines the general lines of American macroeconomic policy in the period from the beginning of the Cold War in 1947 to the end of the 1970s, while the second part refers to the period from 1979 to the present period. Throughout the whole period after the Second World War to the twenty first century the American government, in very different contexts, always had as an explicit priority the prevention of the appearance of a binding external constraint on American macroeconomic policy. The success of these efforts substantially strengthened the bargaining power of the U.S. in relation to other countries and also gave great degrees of freedom for the American State to implement whatever type of macroeconomic policy (fiscal, monetary, exchange rate and incomes policies) that was considered as a priority in each period.

As we shall see in the first part of this paper, the priority of American macroeconomic policy, from 1947 to the mid sixties, was the attainment of a fast rate of growth and high levels of employment in the U.S., together with the fast reconstruction and development of the countries that were allies in the Cold War.

In the late sixties we see the beginning of a period in which the prevailibg social order and the power of the U.S. is contested, both from the internal (distributive conflict, civil disobedience, demands for democratising the State) and from the external side (expansion of the communist block, pressure from the allies for sharing power and for more autonomy from third world countries). In this context, initially the American State kept as a

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tendencies" in capitalism (the so called "theory of history") which would predetermine its historical evolution.

priority the pursuit of rates of economic growth that maintained a high level of domestic employment, in spite of the acceleration of inflation, while at the same time there was the beginning of change of attitude in the policies towards the external allies through the abandonment of the Bretton Woods standard and changes in the energy security policies.[2].

In the second part of the paper we will see how, with the internal conservative offensive in the dawn of the nineteen eighties, the central policy priority changed and become the control of domestic inflation and the resolution of the conflict over income distribution and power in favour of the property owning classes.[3] In the external front, there was a further hardening of the policies towards the allies, in a geopolitical context in which efforts were made to effectively obtain a final defeat of the Soviet Union.

From the mid eighties to the beginning of the XXIst century , with the stabilisation of inflation, the consolidation of the floating dollar Standard and the victory in the internal and external power conflicts, domestic macroeconomic policies again turned to recover growth and the attainment of more socially tolerable levels of unemployment. In the external front, the priority becomes to run and stabilise the new system, in which American leadership is no longer contested. Indeed, we shall draw attention to the remarkable macroeconomic stability of the system during the last two decades.

THE AGE OF KEYNES AND ITS DEMISE [1947-1979].

THE COMPROMISE [1947-68].

- *Three Bretton Woods.*

The Gold-Dollar Standard, also known as the Bretton Woods system, was based on fixed but adjustable exchange rates among the central countries. The parities were defined in relation to the dollar and its fixed official gold price. The official dollar gold price was kept constant until 1971. Control of short term capital flows in most countries was also an important part of the system.

[2] In this paper, besides the properly macroeconomic policies, we shall also examine the American policy concerning oil prices, given its important macroeconomic impact and due to the fact that, in our view, most critical analysts do not give enough importance to the central role that American energy security policies have in the determination of the trend of international oil prices.

[3] In the present paper, we follow the Classical tradition of defining social classes from their insertion in the social production process. Thus, for our purposes, the working class is that fraction of the population that cannot subsist without income from labour.

At the end of the Second World War the international monetary system that had been in disarray since the onset of the Great Depression of the nineteen thirties. The U.S. bargaining position at that time was very strong, since most allied countries had taken loans from the U.S. during the war, besides the fact that a substantial amount of the world's gold reserve was held by the U.S. . The U.S victory in the WWII was not only against the Germany-Japan-Italy axis but, from the economic point of view, it was a victory over most allied countries. It is from this initial position, in which American power was specially asymmetrical and favourable to the U.S., that the post war financial and monetary order was built.

Keynes, as the British representative in the Bretton Woods conference in 1944, participated of the negotiations about the international monetary system that should emerge after the war ended e proposed a type of international currency, which would not be the currency of any specific country and that would generate more symmetric adjustments and stability in international economic relations. Keynes considered that the international monetary system tend to impose a deflationary recessive bias to the world economy and thought about ways of counteracting this bias. In order to do that the international money should not be gold, which Keynes considered bullion expensive and inefficient, completely anachronistic and ill adapted to a modern financial system. The international currency should also not be the national money of a particular country, otherwise this specific country would have the asymmetric advantage of being the only country that could settle its external accounts in its own domestic money. Keynes then proposed a new currency, the "Bancor", which would be used only for international settlements and would be issued by a truly international monetary authority. Besides that Keynes that the international monetary authority (a role that would be played by the IMF) should impose adjustment rules to the countries that would eliminate the deflationary bias of the international monetary system. This bias, according to Keynes, came from the fact that usually, in a fixed Exchange rate system, no country suffered any sanction or entered in any serious difficulty when it incurred continuous balance of payments surpluses and accumulated foreign reserves, while the deficit countries that lost reserves were always required in one way or another to undertake deflationary adjustments. Keynes argued that the international monetary system should include rules that not only forced the deficit countries to trim the expenditure of foreign Exchange but that also led the chronically surplus countries to expand their economies and their imports , in order that the world economy could go towards a full employment situation.

Finally, Keynes saw as essential for the smooth growth of the economy and even of foreign trade that the short term capital flows were rigidly controlled. The idea was to prevent that speculative movements in

the capital account from disturbing the external adjustment of the various countries, allowing that the Exchange rates and foreign reserves were managed in consonance with changes in the real competitiveness and the activity levels of the various economies. These were in broad lines the ideas that Keynes wanted to propose at Bretton Woods. Naturally, that was not what was approved in the conference.

The proposal that was finally approved, by influence of the american delegation had little to do with Keynes original Idea , except for the fact that controls on short term capital flows were accepted. The officially approved proposal at Bretton Woods was that of a system in which the key currencies would theoretically be gold, the U.S. dollar and Sterling (although Sterling would have a secondary role given the high degree in which Britain was a net debtor of gold and U.S. dollars) and in practice , almost exclusively the U.S. dollar. Moreover, the IMF, instead of a world central bank, became an emergency international liquidity source, with very limited resources and specially it turned itself into a kind of international debtors collector agency, with the implication that the brunt of the adjustment would always fall on the deficit countries.

But if the rules of the system were so stacked against Keynes's vision then why everybody considers that the period under the Bretton Woods system was the "Golden Age" of Keynesianism? This paradox may be explained when we distinguish clearly between the three different Bretton Woods systems , namely: 1) the "utopian" system proposed by Keynes ; 2) the rules actually approved at the conference; and 3) the way in which the system was run in practice by the U.S. [4].

The actual rules agreed at Bretton Woods gave strong asymmetric power to the surplus countries and the large surplus country at that time was the U.S. . Thus, there was the danger that the U.S. could try to preserve its surplus, practice protectionism and not tolerate exchange rate adjustments of less competitive countries. If that had happened, the world capitalist economies could again enter a phase of prolonged stagnation.[5]

However, as we known, nothing of this sort occurred, because in 1947 the Cold War started and the priority of American external policy (best exemplified by the Marshall Plan) became that of reconstruction and accelerated development of the countries in the capitalist orbit. This geopolitical factor made the USA operate the international monetary and financial system in a very benign way from the point of view of stimulating the growth of the other central countries. It is for this reason that the Bretton Woods system ended up being operated in practice to a great extent in the

[4] For an analysis of these distinct aspects of the Bretton Woods system see Panic (1995).

[5] In the interwar period, the U.S., even though it had a current account surplus , increased domestic interest rates, raised import tariffs and devalued its exchange rate contributing to a significant extent to cause the Great Depression (see Medeiros & Serrano, 1999).

way Keynes had wanted it to. This happened because of the American policy decision of recovering and developing the capitalist economies both in Europe and in Asia, to defend the "free world" from the threat of communism.

- *Kalecki and the "Crucial Reform".*

In his famous article "Political aspects of full employment" Kalecki (1943) argued that, although the property owning classes would not be against limited government intervention during recessions, there would be strong opposition to a set of policies that eventually implied the *maintenance* of conditions close to full employment in the long run. The opposition would be strong, since those policies necessarily would involve a growing involvement of the State in the economy and the consequent reduction of the importance of the capitalist class and of economic power in society. There would be a substantial shift in the bargaining power (both economic and political) of the workers in the sense of a decrease in "discipline" , increased demands for greater popular participation in decisions of the government and even in internal decisions of big firms , pressure for wage increases etc. These tensions would fatally lead to an increase in the distributive conflict and inflationary pressures which would tend , in democratic capitalist countries, sooner or later to bring to power groups and political parties intent on re-establishing order via orthodox economic policies.

Kalecki based his analysis in the short political cycles of economic policies during the nineteen thirties when, up to the beginning of WWII, almost only the fascist governments managed to keep permanent full employment policies , because in their case, the political and social control of workers was kept directly through repression and violence[6].

In the last paragraph of his article Kalecki said that if someday the capitalist countries could adapt their social and political institutions to the conditions of more or less permanent full employment and the consequent growth of the workers´ bargaining power , a most "fundamental reform" would have then occurred to capitalism.

When we observe the post war experience we see that distribution of income, both at the personal and at the functional level, had improved substantially during WWII, specially in the U.S. . This pattern of income distribution was roughly maintained during the following two decades. On the other hand, inflation in the industrialized countries up to the end of the sixties was not exceptionally low, in comparison with previous historical

[6] According to Kalecki (1943: 352), in fascism "*the necessity for the myth of ´sound finance` ...is removed. In a democracy one does not know what the government will be like. Under fascism there is no next government*".

periods and indeed has shown to be quite persistent. However, the rates of inflation were kept within relatively low limits when we take into account the exceptionally high rates of economic growth and low rates of unemployment during this period.

This performance has been the result of a rather moderate level of distributive conflict in the central capitalist countries in the post war period practically until the end of the sixties, contradicting Kalecki´s predicition.

In the U.S., this low level of conflict and political strife seems to have been the result of the strong, fast and efficient repression of the unions and left wing organisations that happened after 1947.[7] This repression led to the emergence of a general political process and a pattern of union organisation and negotiations in particular, in which the workers would obtain a high level of employment and regular real wage increases in "Exchange" for moderate labour relations which did not contest the power structure either of firms or of the State.

In other industrialised countries , where the Left and the workers movement become stronger , discipline was kept to some extent by the external constraints that the fixed Exchange rate regime imposed to economic policies that tried to accommodate to inflationary tendencies . In some countries where perhaps the Left was "too strong", the compromise with the moderation of claims was due also to the justified fear that a radicalisation could lead to domestic military coups sponsored by the U.S., in the name of the fight of the "free world" against the communist threat.

On the other hand, in the USA, a growing presence of the State in the economy was shown to be necessary in order to ensure the policies of high growth of effective demand required to obtain conditions of near full employment. However, in the American case, the drastic increase in the size of the public sector was done especially thorough the accelerated expansion of military expenditures and of the space programme. This particular kind of government intervention was not in any way subject to the same objection from the part of the property owning classes that could have occurred if there was a need to nationalize part of private investment or to expand "excessively" the social welfare State.[8]

In the other capitalist countries, in Europe and in Asia, the growth of the Social Welfare State and the nationalisation of investment in a few strategic sectors were deemed to be necessary in the name of the process of reconstruction and accelerated development. This greater degree of State intervention was more acceptable given the greater proximity of these

[7] On the politics of labour and capital in the U.S. in the postwar period see Kotz, McDonough & Reich (1994) and Marglin & Schor (1990).

[8] Pivetti (1992) draws attention to this important political aspect of American Military Keynesianism and shows how much military expenditures have been important for the expansion of the U.S. (and the other capitalist economies) in the post war period.

countries to the “battlefront” of the Cold War. Moreover, an essential component of the expansion of final demand in these countries was the fast growth of their exports stimulated by the expansion of the American economy.

- *The Myth of the American Economic Decline*

The american initiatives with the intention of reconstructing and developing the capitalist economies in Europe and Ásia involved various aspects such as: 1) changes in the Exchange rate of other countris- the official gold price of the dollar remained stable but the U.S. not only tolerated but actually supported the depreciation of the currencies of other countries to make them more competitive relative to the U.S. ; 2) the promotion of U.S. foreign direct investment flows to the allied countries ; 3) american technical and technology transfer missions ; 4) military expenditures abroad using allied countries as suppliers ; 5) opening up of american markets for imports of allied countries in favourable terms to them 6) direct external aid in terms of grants , such as in the Marshall Plan; 7) tolerance without retaliation with allies´ protectionist tariffs , export subsidies and non tariff trade barriers to american products in the allied countries ; among many others.

Naturally, the success of this set of policy measures led over time to a continuous reduction of the American current account and trade surplus, which turned into small deficits in 1971. Moreover, the success of these policies made not only the allied economies grow much faster than the American economy but also (due to the usual increasing returns to scale and endogenous technical change) led to a substantial reduction of the vast initial productivity differential between the American economy and the other capitalist countries in various industrial sectors.

Many analysts, in our view incorrectly, have interpreted these reductions in the American external surpluses and the recovery and catch-up of the allied countries as a sign that the U.S. was going through a phase of “economic decline” during the Bretton Woods period- given that, from 1946 to 1970, various indicators, such as the American share in world exports and world industrial production naturally suffered a large reduction. Moreover, from that it is argued that the end of the Bretton Woods system was caused by the great decline of U.S. power relative to other capitalist countries.

Although it is a fact that, once properly reconstructed and prosperous, the other allied capitalist countries have increasingly questioned various American decisions and initiatives and tried to influence more the decisions of the supposedly multilateral international organisations, there seems to be great exaggeration in these analyses. It seems evident to us that the extent of the success of the economic recovery of the other allied

capitalist countries and their export driven growth could not be explained without the clearly favourable stance of American economic policies.[9].

Taking this historical perspective is important in order to qualify the Idea of the great American economic decline over this period. Otherwise, it is not easy to understand how, in the beginning of the XXIst century the U.S. is still the world's greatest economic power.[10]

The growing trade integration and the development of the international financial and monetary system in a period of fast economic growth were results of the U.S. strategy to win the Cold War. We cannot underemphasise that it is indeed a period of fast growth of effective demand, of output, of high rates of job creation, high productivity growth, recovery of European countries, successful development processes in the capitalist periphery and great expansion of world trade. What nowadays is interpreted by many of a period marked by the success of free market economies or the so called "globalisation" was, in reality, the result of an international arrangement based on highly interventionist and entirely based in a very "generous" stance of the dominant capitalist State.

The "Golden Age" certainly was not a spontaneous market process. If we were to observe the economies of Europe, Japan and the rest of Asia in 1945 we would not forecast any "Golden Age" for the subsequent decades. The situation in these regions was of an enormous power asymmetry in relation to the U.S. due to the devastation caused by WWII in these countries, including Great Britain. The "Golden Age" period was called by Hicks(1974) "The Age of Keynes" because it was the era in which the developed capitalist countries were run according to the ideas of Keynes about a regulated capitalism. However, there seems to be no doubt that the reason for the acceptance and widespread application of these ideas was essentially based on the political realities of the Cold War.

- *The Distributive Compromise and the Creeping Inflation*

During the first two post-war decades the high rates of economic growth and low unemployment rates did not lead to increasing distributive conflict and accelerating inflation. Besides the fixed exchange rate regime, another

[9] For instance, even the European monetary integration has its origins in the insistence of the U.S. authorities that Europe should assemble a regional payments system in order to save on the amount of U.S. dollars required for intra Europe trade flows. In spite of initial resistance of various European countries , the European payments systems went ahead and over time became the operational nucleus of what later was to become the European monetary system (De Cecco, 1979), which some decades later transformed itself in the Euro, the common European currency.

[10] About the myth of the U.S. decadence see the interesting "Realist" political analysis of Nau (1992), which is not too much affected by his unrealistic orthodoxy in economic matters.

important factor that played a role in keeping inflation stable was the American control of Middle East oil, which allowed practically unchanged nominal oil prices up to 1970.

In this environment of relative stability, both the trend of dollar commodity prices in the international market and the overall world export price index (measured in U.S. dollars) remained practically stable in nominal terms during more than twenty years.

Throughout this whole period, American nominal interest rates (followed by the other countries) were relatively stable, what has certainly contributed to the stability of nominal profit margins of firms, given that in the long run interest rates represent, either directly as financial costs or indirectly as the opportunity cost of capital, the floor for the rates of profit of the productive sectors. [11]

At the same time, the low rates of inflation followed the pattern of the so called “creeping inflation”. This type of inflation is the result of the effort of the workers movement and unions which , more than questioning the functional distribution of income and the existing power relations, tried (via solidarity and fairness mechanisms) to reduce (or at least keep stable) the relative wage differentials among different groups of workers.

The more combative and best organised groups of workers obtained wage increases linked to (though often lower than) the high productivity gains of the most dynamic industrial sectors. In these leading sectors, which in most countries outside the U.S. where export sectors, labour productivity grew much faster than in the rest of the economy. The nominal wage increases in these sectors, under pressure form the workers unions, was to a large extent also extended to workers employed in sectors that had low productivity growth (in general non tradable sectors and services).

To the extent that the differential productivity growth between the two types of sectors was high and the degree of labour solidarity (through unions and/or State incomes policies) was sufficiently strong, the increases in the nominal wage bill for the economy as a whole were higher than the average growth of productivity of the economy as a whole. These increases in wage costs were passed through prices, in a context in which nominal profit margins were relatively stable, and lead to moderate but quite persistent rates of inflation that became known as “creeping” inflation[12].

Therefore this two decades where a period of moderate inflation, combined with increasing real wages and a more or less stable functional distribution of income (profit share). In this context the low but positive inflation seems to have had the role of allowing that, through the “creeping” inflation, the benefits of technical progress were distributed more equally

[11] On the money rate of interest as a floor for normal profit margins and rates see Pivetti (1991), Serrano (1993) e Stirati (2001).
[12] On the "creeping” inflation, see Kaldor (1976).

stabilising or even reducing relative wage differentials in the industrialised countries. On the other hand, the barrier of the fixed exchange rates and of stable dollar international export prices, together with the stability of long term nominal rates of interest (which determine both financial costs and the opportunity cost of productive capital) , seems to have allowed the wage share to remain relatively stable in most industrial countries. Thus, in spite of the very high rates of growth of output, productivity and of an intense process of structural change, this period was also in a sense a "Golden Age" in distributive terms.

When Kalecki returns to the discussion of political aspects of full employment in a 1971 paper (Kalecki & Kowalik, 1971), the success of this post war compromise makes him coherently argue that, indeed, there has been a "crucial reform" in the capitalist countries. This economic and social performance of the capitalist economies regulated by the State, according to Kalecki, simultaneously moved away the possibility of economic collapse, of war between the main capitalist countries and also of socialist revolution in the advanced countries, where there was a growing material prosperity of the working class. According to Kalecki the capitalist countries had "learned the trick" of avoiding crises and the disorder of unregulated capitalism through government intervention.

At the end of this article, however, Kalecki draws attention to the fact that the relative stability of reformed capitalism depended crucially on a high degree of "social conformism" and that this perhaps was beginning to change with the contestation led by social movements that started in the late sixties – although in his view this contestation did not seem to threaten the existence of capitalist property[13].

THE CONTESTATION (1968-1979).

- *The Wage Explosion and the End of the Compromise.*

In the last years of the nineteen sixties were marked by a sudden reduction in the degree of "social conformism" in the industrialised countries with the arrival at the labour market of new generation of workers that had grown up in an unprecedented environment of political and economic security. The degree of union militancy increased drastically, simultaneously with the rise of student movements and civil rights groups. In the case of the U.S. the great impetus to this political radicalisation and

[13] Garegnani (Cavalieri, Garegnani & Lucii, 2004) also draws attention for the fact that the contestation by the social movements at the end of the sixties had no chance of leading to a change of regime, both because of western prosperity and also due to the loss of attractiveness of the really existing socialist alternative, given the worsening of the economic performance and the widespread dissatisfaction with the political situation in the Soviet Union.

contestation of the ruling social order was given by the racial conflicts and the opposition to the Vietnam War.

The main direct economic consequence of this new situation was a great increase in the distributive conflict in the all the central countries (Cavalieri, Garegnani & Lucii, 2004). There was also an increase, especially in the U.S. in the demands for social expenditures and pressure for those to be financed through progressive taxation of property incomes.

The increase conflict led to a jump in the rate of growth of money wages, starting gradually in the U.S. and then spreading rapidly to practically all industrial countries (UK, West Germany, Italy, France, Japan, Sweden, New Zealand, Canada, etc.) in 1968. In most of these countries the rate of growth of nominal wages in the period 1968-71 – before the large increase in international commodity prices of 1972-3 and of the first oil shock of 1973- was more than twice as fast as the rate of growth in the preceding twenty years , a phenomenon that became known the "wage explosion".[14]

The wage explosion led to an acceleration of inflation as the nominal wage increases were passed on to prices. However, the nominal profit margins did not increase sufficiently to compensate for the permanent increase in the growth of wage costs and thus the degree of pass through was only partial, being larger in the U.S. than in the other countries.[15]For a number of reasons the U.S. central bank did not increase nominal rates of interest in line with the increase in the inflation rate, something that made more difficult for firms to the increase their nominal profit margins and at the same time eroded the real remuneration of owners of financial assets. The wage explosion led, to different degree in the various central countries, to the compression of real profit margins and of the share of profits in income.[16] Note that this phenomenon occurred before the big increases of

[14] About the Wage Explosion see Cavalieri, Garegnani & Lucii (2004), Nordhaus (1972) and Kaldor (1976). It is important to note that before the substantial decline in growth rates of these countries after 1973 we do not observe very significant changes in the rate of growth of labour productivity. The post-1973 reduction in the growth of productivity seems to be more of a consequence of the decline in the rates of economic growth (see Cesaratto, Serrano & Stirati, 1999).

[15] For empirical evidence of the limited and partial pass through of cost increases to prices in that period see Labini (1984) , Cavalieri, Garegnani & Lucii (2004) and Marglin & Schor (1990).

[16] Note that Kalecki (and his modern followers) argue that wage cost increases can not reduce the share of profits if profit margins are given. This conclusion, however, is only valid in the case in which one arbitrarily assumes that what are given a priori are the **real** profit margins, in which case prices will increase as much as costs in each period , without any lag. In fact , with given nominal profit margins , an increase in the rate of growth of costs increases prices only with a lag and reduces the real profit margins (see Serrano, 1993 and Stirati, 2001). It is true that Kalecki (1971) himself changed his mind on this issue and in his last paper on income distribution admited that increases in money wages can reduce (real) profit margins.

international raw materials and commodities in general in 1972 and of the first oil shock of 1973.

- *The Beginning of the Profit Squeeze and the Acceleration of Growth.*

The squeeze of the profit share naturally generated great political dissatisfaction among the entrepreneurs. The reduction of profit margins implies not only that a smaller share of what is produced is appropriated by the property owning classes but also reduces, if persistent, the normal rate of profit (the rate of profit that can be obtained in new investment, which install new productive capacity in line with the expansion of effective demand).[17]

However, it is important to note that this reduction of profit margins and of the normal rate of profits , in spite of generating the usual protests from the capitalist class, it did **not** have direct negative effects on the pace of private productive investment.[18]

In the first place because the fall in the real profit margins and normal rate of profits were accompanied by equivalent reductions in the real rate of interest , apparently without altering significantly the difference

[17] Here we must mention another deficiency in the theory of Kalecki and his follwoers. It is important to note that the rate of profits that matters for the formation of profit margins and prices and alos for the expected return on new investment projects is necessarily that that would obtain at the **normal** or planned degree of capacity utilization and not the current rate of profit on the already installed capital equipment, which naturally varies with the **actual** degree of capacity utilization. The question is that, on one hand , competition (actual or potential) does not allow firms to plan to install on purpose plants whose capacity is smaller than expected effective demand in order to keep these plants permanently overutilised. On the other hand, it does not make sense to build on purpose plants systematically bigger than what is justified by the size of the market (taking into account of course a margin of planned spare capacity). Thus, it is the normal rate of profits that determines the profit margins and the limit prices that competition imposes on all sectors, and therefore also the rate of return on new investment projects. On this point see Cavalieri, Garegnani & Lucii (2004), Petri (1993, 1997) e Ciccone (1991).

[18] Here the confusion comes from the "neomarxists" (see Marglin & Schor, 1990) which mechanically try to associate the squeeze in profit margins to a reduction in pace of investment by arbitrarily assuming that investment is a direct function of the level of the profit share. The fact that lower profit margins lead to lower normal rates of profit does not imply that the most lucrative option in this situation will be a reduction of investment and the size of productive capacity. The adequate size of productive capacity does not depend on the level of the normal rate of profit but on the size of the demand of those who can pay the prices that guarantee that the minimum normal profitability requirement is met, irrespectively if this normal rate is high or low. See references at the previous footnote and Serrano (1988 e 1996, cap.3). It is important to note that Marglin (1990: 19-20) himself admits that the fall in the profit share was **not** followed by a fall in the investment share, which only started to fall in the industrial countries many years later (he , however, attributes this discrepancy to a presumed an non observable divergence between the actual and expected profit share).

between the rates of profit and of interest which could affect the level of investment.[19]

Besides that, although politically entrepreneurs prefer higher profit margins and normal profit rates, capitalists do not "invest as a class" but according to the existing investment opportunities and the pressure of competition. Their investment decisions are **not** an inverse function of the level of the normal rate of profits but a positive function of the size of the market. In the long run the size of lucrative investment opportunities depends on the level and rate of growth of effective demand- the demand of those who can pay normal prices (that price that allow firms to obtain the normal rate of profits, which defines the minimum accepted standard of profitability). If effective demand is expanding, whether normal profit margins and rates happen to be "high" or "low", competition and the search for maximum profits impel the firms collectively to expand productive investment.[20]

In the U.S. and other capitalist countries, the increased wage share, by distributing income towards classes that have a higher propensity to consume, certainly led to the increase in the induced consumption of the workers. This expansion of consumption, by increasing effective demand led to an increase in the level of private investment, even with lower profit margins and normal rate of profits. Thus the compression of profit margins at the end of the sixties had the initial effect of accelerating even more the economic growth of the main industrialized countries.

The important point to be kept in mind is that the squeeze of profit margins does not directly cause a crisis or a fall in the rate of growth of the economy. What the profit share squeeze can cause, as Kalecki had noted in his 1943 article, is a change in the orientation of economic policy in a contractionary direction which, in the name of the control of inflation, could produce enough unemployment to weaken the workers bargaining power in order to allow the restoration of the general conditions of profitability, and in particular, the guarantee of sufficiently positive real rates of interest.

However, in the period 1968-71, this was **not** the reaction of American economic policy. On the contrary, the initial response of the American government to the acceleration of inflation was, in president Nixon's first term, the maintenance of the expansionary macroeconomic policies. The central priority of the administration in that particular political

[19] On the inexistence of an inverse relation between the interest rate and non residential investment when the rate of interest and the normal rates of profit move in the same direction see Garegnani (1978-9), Pivetti (1991) e Petri (1997).

[20] Note that the size of the market measured by effective demand limits the trend of the **aggregate** volume of investment opportunities even in the presence of individula investment projects embodying innovations and that try to obtain profits way beyond normal standards and/or steal market shares from rival producers. See Cesaratto, Serrano & Stirati (2003).

context was to avoid the increase in[21]. Thus, fiscal policy continue its expansionary stance, due both to the military expenditures and also to the social expenditures resulting from the social welfare policies of the "Great Society" and " War Against Poverty" projects, inherited from President Johnson. Monetary policy was also expansionist, with reductions in nominal short term interest rates up to 1971, intended to prevent recessions by stimulating residential investment and the sale of consumer durables.

In this situation the fight against the accelerating inflation was made through incomes policies. Wage and price controls were introduced in the U.S. in 1971 and had much more effect in reducing the growth of money wages than that of prices, although for a limited period of time. Naturally, the growth of money wages, productivity and the degree in which labour cost changes were passed on to prices was very different in different countries. In general, the American economy had more inflation and a lower increase in real wages than most other advanced capitalist countries (Cavalieri, Garegnani & Lucii, 2004). In the fixed exchange rate regime, the higher relative rate of inflation of the U.S. reduced this country's competitiveness relative to its main trading partners, in spite of the appreciation of the German Mark from 1968 and of the Japanese Yen after 1970. This increased the internal pressure on the U.S. government of the sectors more exposed to external competition asking for a unilateral general depreciation of the U.S. dollar.

- *"Nixon's Dilemma".*

However, a general depreciation of the dollar, the key currency of the Bretton Woods system, was not a simple policy decision. When the problem of the overall deficit in the balance of payments of the U.S. and its implications for the international monetary system were discussed in the 1960s, the U.S. still had a trade and current account surplus. However, a large overall balance of payments deficit was already occurring due to the large capital outflows on account of foreign direct investment of the American multinational corporations, military expenditures abroad, foreign aid and loans to other countries.

The accumulating deficits were paid mainly in dollars instead of gold. Moreover as the U.S. did not have yet a current account deficit, its net external liability position did not deteriorate because the long term capital

[21] In spite of his orthodox neoclassical interpretation De Long (1995a e 1995b) documents very well the desire of the american government of avoiding recession in this period. Nelson (2004) documents well how the White House, the Treasury and the Fed , from Nixon until the last year of the Carter administration , had a vision , that this orthodox author think profoundly wrong, that the inflation of the nineteen seventies was derived from distributive conflicts and the oil shocks, and saw recessions as being ineffective in the attempt to fight it.

outflows were fully offset by the short term capital inflows that happened when U.S. dollars were accepted as means of international payments and the central banks of other countries accumulated dollar reserves, that were invested in liquid American public bonds. Therefore, in spite of the overall deficit in the balance of payments the U.S. was not losing gold, for its net gold liabilities were not increasing.

In this sense the American deficit was very different from the deficit of the other countries, since it was caused by long term capital outflows that were quickly transformed into short term dollar capital inflows. The only direct effect of these balance of payments deficits was that the proportion of dollar denominated assets in the world and the stock of gold store in Fort Knox (where the American gold reserves where kept) was growing all the time.

But in any case this mechanism allowed a great asymmetry between the U.S. and the other countries, because as the other countries accepted dollars as payments, the U.S. could finance an overall balance of payments deficit of virtually any size.

In this system, in spite of the freedom that the U.S. had of actually clearing its balance of payments in its own currency there were two constraints related to the need of keeping the convertibility in gold.[22].In the first place the U.S. could have deficits in the capital account but should try to avoid chronic deficits in the current account. If the U.S. had successive current account deficits, this would mean that its net external liabilities would be increasing, for in that case, there would be an increase in the net claims of other countries against the U.S. As in the Bretton Woods system this external obligation even when denominated in dollars were in principle fully convertible in gold, this would imply that the U.S. would begin to lose gold.

Therefore if the U.S. had current account deficits would progressively lose its gold reserves. If that occurred the idea that the dollar was as *good as gold* would be undermined. And as American gold reserves started to fall naturally international payments would tend to be made directly in gold instead of U.S. dollars and the dollar would tend to lose its status as a key currency.

The second constraint that the gold-dollar Standard imposed on the U.S. was the need to keep the official dollar price of gold fixed. If the official dollar gold price started to change this could induce massive speculative movements and possibly the abandonment of the U.S. dollar for international settlements. This is why the official gold price in dollars was kept unaltered from 1947 to 1971.

[22] A more detailed analysis of the balance of payments position of a country that issues the key currency in a system referred to gold cna be found in Serrano (2003).

But the fixed gold price created a problem for the U.S. because this country could not take the initiative of devaluing of revaluing its currency relative to the other countries. In a gold referred system the exchange rate is fixed when the government declares the official gold price of that country. During the Bretton Woods system a few countries changed their parities changing the official gold price in their currencies, some of them with the active support of the U.S. as part of the strategy of reconstruction and fast development of its allies. When a country wanted to devalue its currency all it had to do is to fix a higher official price of gold in its own currency, or symmetrically, fix a lower official price of gold to obtain an appreciation. The only country that could not do that was the U.S., which should not change the official dollar gold price.[23].

The problem was that these two constraints put the U.S. in a major contradiction. On one hand, the very success of the American strategy of reconstruction and development of other capitalist countries (which included accepting some depreciation of the currencies of other countries) was progressively reducing the American trade and current account surpluses. But to keep the international role of the dollar it was necessary to prevent the occurrence of current account deficits. At the same time, the simplest means of improving American external competitiveness was through a depreciation of the dollar. But how to devalue the dollar without threatening its position as the international currency? Great Britain, during the gold-sterling standard had faced (and not managed to solve satisfactorily) a similar problem, the difficulty of reconciling the role of international currency (and the associated advantage of not having an overall balance of payments constraint) and, at the same time, protecting its real competitiveness.

That was the problem facing the U.S. which we have called elsewhere the "Nixon Dilemma" (Serrano, 2002). This dilemma came from the desire of devaluing the exchange rate and at the same the impossibility of doing it, within the rules of the Bretton Woods, without threatening the position of the dollar as the key international currency.[24]

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[23] If the U.S. wanted to devalue the dollar against the currency of some ohter country, without jeopardizing the special role of the dollar in the system , the americans would have to ask that country to lower their official gold price in their own currency.

[24] Usually , this is not the way in which the main contradiction of the Bretton Woods system is duscussed. It is usually argued that since there was less and less gold in Fort Knox relative to the dollars circulating in the world and at the same time the beginnings of the international financial deregulation and the growth of the Eurodollar credit markets added even more dollars to the world economy, reducing even further the actual gold backing of the U.S. dollar. The markets then would have imposed on the U.S. government the abandonment of gold convertibility , the end of the fixed official dollar gold price because of this lack of "backing". These analyses that often refer to the so called "Triffin Dillemma" crucially depend on a series of unrealistic "monetarist" assumptions. A detailed discussion and criticism of these interpretations can be found in (2003).

It is important to stress that the alternative of following contractionist macroeconomic policies to sustain the existing arrangement was never even seriously contemplated by the American government because this was completely at odds with the American internal and external policy priorities and would mean the unacceptable admission by the U.S. of a binding external constraint on its growth and to its economic policies in general.

During the sixties there were many attempts to negotiate a change in the system with the U.S. allies. Some countries, such as France, wanted to increase the actual role gold in the system, with the fairness argument that if all countries settled their international payments in gold, no country would have exclusive advantages (although, by chance, France happened to have at the time a good part of its foreign reserves in gold). However, in a system in which gold played a more important role in payments the U.S. would have a balance of payments constraint like all the other countries. Besides that, great gold producing countries such as the Soviet Union and South Africa would come to have a lot of bargaining power in the international economy. It is evident that the U.S. had not interest in accepting this kind of reform.

Another proposal, in ways similar to the original Keynes proposal in the Bretton Woods conference, was that of using for international settlements the so called Special Drawing Rights (an accounting money invented by the IMF) with initial balances issued in proportion to the importance of each country in world trade. The U.S. vetoed all the attempts to really increase the importance of the SDR and the Idea that it could become the new, truly international, money. As a counter proposal the U.S. suggested that overall dollar depreciation could be made, keeping the official dollar gold price constant, through a coordinated and proportional reduction of the e official gold price on the other national currencies. However, the other countries also did not accept this American proposal.[25]

Given the stalemate, in 1971 president Nixon took the unilateral decision of abandoning the gold convertibility of the dollar. Moreover, given the difficult of agreeing to specific new exchange rate parities with its main partners Nixon also imposed unilaterally an extra tariff on all imports that should be kept until the allies got to an agreement about exchange rates, agreement that only came to happen in 1973.

- *Commodities, Oil and Stagflation.*

Due to the simultaneous occurrence of accelerated and synchronised growth of both the American and world, the increase in inflation in the U.S., low nominal and real short term dollar interest rates, and the growing creation of offshore credit in the Eurodollar circuit, the end of the gold

[25] About these various failed negotiations, see Solomon (1982).

convertibility of the dollar led to a explosion of dollar prices of raw materials and other international commodities starting in 1972. The commodity prices increased much faster and further than in any previous boom and by much more than the previous increase in the dollar prices of industrialised goods.

However, it is important to note that this commodities shock did not prove to be permanent and, in the long term, did not revert the secular trend of the terms of trade of foodstuffs and raw materials to decline (although at the time many analysts believed that trend had been broken).[26] In any case, this shock marked the beginning of a long period of extremely high volatility in international commodity markets, no doubt as a result of the new regime of floating Exchange rates and increasing financial liberalisation.

Since 1971, OPEC started to press for increases in the international oil prices and a higher share of oil royalties, which were eroded by the dollar inflation. Concerns about keeping good relations with the Arab countries in an region of great geopolitical tensions, added to the preoccupation with strategic energy security and the economic viability of the American domestic oil industry (whose costs had gone up considerably over the years of higher inflation) led the U.S. to accept increases of about 50% in the international oil price from 1971 to 1973. At the same time, in 1971, the U.S. started to increase massively its oil imports from the OPEC countries.

In august 1973, as part of the energy security policy, the U.S. froze the price of domestic oil produced by already existing wells, with the purpose of preventing a predatory exploitation in these wells; at the same time the government deregulated entirely the price of oil coming from new wells in American soil, with the purpose of stimulating investment in the latter. Simultaneously, in order to avoid any supply shortage for a fast expanding economy in a tense international situation, the government abolished for good the official oil import quotas. This had the immediate effect of increasing even further the demand for oil from the OPEC countries. Under these conditions, the Yon Kippur War between Israel and

[26] Typical examples are Hicks (1974) and Kaldor (1976), which conclude that a rigidity in the world´s supply of raw materials had emerged. Later Kaldor admitted that he changed his mind (Kaldor, 1989) after reading Labini (1984) who showed that only the volatility of commodity prices had really changed. By his turn Hicks (1989) does not mention again the problem of scarcity of raw materials in his analysis of commodity prices and his later analyses implictly confirms Prebisch´s idea of a falling secular trend of the terms of trade of commodities. For more recent empirical evidence that the commodities price shock had temporary effects on terms of trade (although volatility really increased drastically ever since) and that the negative secular trend in the terms of trade is still valid (perhaps at an stronger pace after 1980) see O´Connell (2001), Ocampo & Parra (2004), Bunzel & Vogelsang (2003) and Cashin & McDermott (2002).

Arab countries excluded a few months afterwards was the trigger of a massive increase in the international oil price, which was raised almost fourfold in the year of 1973.

We can thus see that the first oil shock, although represents a situation of relative lack of control of the U.S. – being no doubt a result of a distributive conflict between the oil producing versus the industrial countries, in an historical context in which American leadership was being questioned- was only of such magnitude and impact due to the expansionist American macroeconomic policy and, in particular, due to the new energy security policy of the U.S..[27]

The American energy policy had as a priority the preservation and growth of the American domestic oil reserves and at the same time sought to guarantee the uninterrupted supply of oil for the American economy. These priorities were kept even after the first oil shock, in spite of the evident costs of this policy, in particular for its presumed allies. These costs included the increase of inflation in the U.S. and in the rest of the world, a large transference of income to the oil exporting countries (although a sizeable part of this ended up with the American multinational corporations anyway) and, last but not least, the large balance of payments difficulties of most other industrial countries which, differently from the U.S., could not issue the dollars needed to pay OPEC.

These commodity and oil price shocks ended up sharply slowing down the growth of the world economy. The oil crisis had a direct recessive effect coming from the redistribution of income in favour of OPEC countries that in the short run could not possibly spend a high proportion of these gains in extra imports. On the other hand, the rise in oil and commodity prices gave new impetus to the acceleration of inflation in the rich country, where formal or informal wage indexing schemes had been put in place in the early seventies in many countries (in many cases ironically with the purpose of moderating and organizing the increases in money wages). The acceleration of inflation in virtually all industrialized countries and the balance of payments difficulties of countries other than the U.S. gradually led to the generalised introduction, although in some countries still in a partial and hesitant form of contractionary macroeconomic policies – the so called *stop and go*.

The oil and commodity price increases aggravated even more the distributive conflicts inside the industrial countries, for the adverse change in the terms of trade contributed to a greater profit margin squeeze, while at

[27] It is important to note that in the U.S. the energy security policy has always been another name for a set of interventions that have, in general, preserved the profitability of domestic american oil industry. Among the very few authors that stress the importance of the American energy policy for the strength of the bargaining power of the OPEC in different periods see Parboni (1981), Ayoub (1994) and Rutledge (2003) and also the Sraffian analyses of Piccioni & Ravagnani (2002) and Roncaglia (2003).

the same time, tended to reduce the real wage of workers in terms of consumption goods.

These conflicts, by their turn, made inflation in the industrialised countries accelerate even more. The rise in the oil prices and in the prices of industrialised products led later to further, compensatory increases in the nominal dollar prices of commodities from the side of their costs of production. However, the inflation in the industrialized countries was so intense that ended up reducing again the non oil commodities terms of trade, which by the end of the 1970s had already lost most of the gains from the beginning of the decade.[28]

In the U.S., where workers had a weaker bargaining position, the strongest effect in terms of reducing profit margins was due to the changes in the terms of trade connected with the oil shock. Besides that the depreciation of the dollar, which increased the prices of American imports of products of other industrialised countries that, differently from commodities, did not have prices directly quoted in dollars, also contributed to U.S. inflation. .[29]

In the other rich countries, in general, the "real wage resistance" was stronger and the passing on of domestic cost increases to prices more difficult in these more open economies.

The permanent inflationary and temporary distributive shock due to the increases in commodity prices and the permanent shock caused by the increase in the relative price of oil (whose nominal price was set in U.S. dollars) had very different effects on the different countries. In the U.S. the impact of those prices increases was in part weaker because of the lower import propensity of the American economy relative to others. But on the other hand the fact that most commodity prices are denominated in dollars made the inflationary impact stronger in the U.S... On the other industrial countries the impact of rising dollar import prices was aggravated by the

[28] The importance of the volatility andspeculative movements of commodity prices for the american and world inflation seems to have been greatly overestimated by many authors such as Tavares & Belluzzo (1986), Schulmeister (2000) and more recently by the author of the present work (Serrano, 2002 e Medeiros & Serrano, 1999). The problem with this view is that teh accumulation of speculative inventories cannot have prolonged effects on prices because those inventories, at some point must be liquidated. Besides that, any more systematic price increase, unaccompanied by cost increases , fatally leads to a fast (a nd disorderly) expansion of the international supply of commodities. In fact, a more detailed examination of the available data shows that the initial commodities price shock was quickly corroded by the oil price shock and by the accelerating inflation of the industrialized countries (see references in footnote 26 above). The proof of that is the fact that throughout the 1970s the terms of trade of the non-oil exporting developing countries fell considerably (O´Connell, 2001).

[29] These are the goods that Schulmeister (2000) calls the *non-dollar goods*, in contradistinction to commodities and oil that would be the *dollar goods*.

higher import propensities but, on the other hand, dampened partially in the countries who revalue their currencies relative to the dollar.

It is in this context of great instability that in 1979, under the impact of the recent Iranian revolution that the second oil shock occurs, almost trebling oil prices in dollars. The capitalist economies arrive at the end of the nineteen seventies, with reduced growth, accelerating inflation and with the post war order, the "the Age of Keynes" completely shattered both at the internal and at the international level.

THE AMERICAN REACTION AND THE STABILISATION OF THE FLOATING DOLLAR STANDARD [1979-2004].

RESTORING HIERARQUY (1979-1984).

- *Paul Volcker.*

The arrival of Paul Volcker as chairman of the FED in 1979, still during the Carter administration, started the beginning of the conservative counterattack in the U.S. Volcker was keen on stabilising the system and quickly gave up the attempt to coordinate policy together with the other industrialised countries since they kept insisting on reforms of what is now know as the "architecture of the international financial and monetary system" with the purpose of reducing the asymmetric power of the U.S. dollar. Not long after the second oil shock Volcker unilaterally raised American interest rates, starting a new long historical period of high real interest rates. This policy, together with the repercussions of the second oil shock led the world economy to enter a serious recession and marks the beginning of a period of appreciation of the dollar that lasted until 1985.

The other industrialised countries were forced to follow closely this unprecedented increase in interest rates, or else would have to face intense capital outflows and large and possibly uncontrolled exchange rate depreciations that would add to the current inflationary pressures. Since this period the industrialised countries seem to have tacitly given up any serious attempt at questioning the dollar supremacy and Europe defensively started to assemble and European monetary system in order to organise and stabilise exchange rates within the countries of European Community.

In any case, the high dollar interest rates attracted an enormous amount of foreign capital to the U.S. The American external current account deficit increased considerably during this period of appreciation of the dollar. This increase led a number of authors to argue that the main objective of the dear money policy was that of attracting foreign capital to

finance the American current account.[30] However, as the dollar was (and is) the international money there was no such need. Indeed, American imports throughout the whole post war period until the present, even of those products whose prices are not set in dollars, always have actually been paid in U.S. dollars. Therefore the peculiarity of the American current account deficit is that it is financed at the very moment and by the very transaction that generates it. The international do affect the dollar exchange rates, but not the ability to finance the current account deficit. Moreover, as we saw above, ever since the end of gold convertibility in 1971 the U.S. got rid of any type of external constraint and accordingly stopped worrying about the occurrence of current account deficits.

The world recession and the high dollar interest rates led to actual falls in the nominal prices of commodities and oil in the international markets. In the U.S. inflation started to slow down gradually and at the same time the situation of the highly indebted developing countries became critical and a crisis ecloded in 1982 , after the Mexican external debt default and the subsequent joint decision of banks and the U.S. government to cut credit to most developing countries.

Besides the fall in commodity and oil prices the disinflation in the U.S. also benefited, to a lesser extent, from the reduction in the increase of the dollar prices of industrialised products imported from the developed countries which was caused by the appreciation of the U.S. currency.

- *Ronald Reagan.*

With the argument that inflation was taking too long to fall, the high interest rate policy was kept and, partially as a result of that, the U.S. economy suffered its worse recession in the post war period.[31]President Ronald Reagan took office in 1981 and started right away a frontal attack on the working class, the union movement and the other socially progressive forces in American society. Besides direct confrontation to weaken the unions, Regan dropped the income policies of Nixon and Carter and push forward the process of industrial deregulation. This deregulation process, in the name of promoting competition and innovation, led to mergers and acquisitions of firms that were “restructured” under new management, often reneging old contracts made with unionised workers. Deregulation , together with the strong dollar , stimulated a process of industrial delocalisation in

[30] See , for instance, Tavares (1985) and in part even Pivetti (1992).

[31] Note that increases in short term (*ex-post*) real interest rates redistribute income from debtors to creditors. This usually leads directly to permanent reductions in the demand for consumer durables and residential investment. The financial impact of these increases on non residential or productive investment tends to be temporary since persistently higher levels of real interest rates tend to make firms increases their gross profit margins (see references in note 19 above).

which the parts of the productive chain that were more intensive in less qualified labour were progressively transferred to plants situated in developing countries.

Thus, in the beginning of the eighties the bargaining power of American workers suffered a serious blow. Besides the open hostility to unions and the industrial restructuring, with the growing external competition and the threats of firms of deepening the delocalisation process, the situation was aggravated by the fact that the open unemployment rate reached record levels that had not been seen since the Greta Depression of the nineteen thirties.

Naturally, all this led to a considerable and quite persistent reduction in the pace of nominal wage increases, with substantial reductions in the levels of real wages (especially that of the less qualified workers) in spite of the falling relative prices of imported products and oil.[32]Moreover , the weakening of unions and of less qualified workers, the lack of nominal increases in the minimum wage and some social benefits and the permissive attitude toward the immigration of less qualified workers all contributed to a drastic increase in wage and salary inequality, which had the additional macroeconomic effect of eliminating the pressure of creeping inflation. Besides the negative effects on the functional and personal distribution of income[33], the political defeat of unions and workers also reduced considerably the "inflation inertia" of the American[34].

The long period of high nominal and real interest rates, in a context of these various favourable supply shocks led not only to the recovery but also to an increase of nominal and real profit margins in the U.S. Due to the increase in financial costs and of the opportunity cost of capital the pace by which the price increases fell was systematically smaller than the pace of the reduction in the growth of the costs of production.

A somewhat similar movement was later observed in the main industrial countries where the new era of high real interest rate came together with increases in gross profit margins, in spite of the strengthening of domestic and international competition promised by deregulation and the greater openness of the economies over this period.

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[32] Official data from both the Bureau of Economic Analysis and the Bureau of Labour Statistics show significant reduction in real wages in the U.S. in the first half of the nineteen eighties, both in the industrial sector and in the economy as a whole (see also Pollin, 2002 and Cavalieri, Garegnani & Lucii, 2004). Note that Tavares (1985) and Tavares & Belluzzo (1986) incorrectly affirm that real wages increased in the U.S. during that period.

[33] For empirical evidence of the dramatic increase in wage inequality in the U.S. since the n1980s see Piketty & Saez (2001). For data on the substantial fall in real wages since that period see Poterba (1997) and Krueger (1999).

[34] Estimates of the drastic fall of "inflation inertia" in the U.S. economy (and also in other industrial countries) since the first half of the nineteen eighties can be found in Martin & Rowthorn (2004).

The increase in interest rates did not provoke a fall in net profit margins- i.e. net of interest payments- of firms, because the increase in gross profit margins was enough to make the real wage become the adjusting variable. Real wages fell or at least grew less than productivity in all central countries in the nineteen eighties. These distributive changes show that the new era of high real interest rates did not cause a permanent conflict between productive capital and financial capital; instead they reflect a major reduction of the bargaining power of workers against the property owning classes in general.[35]

After the international financial crisis of 1982, American interest rates start being slowly reduced. However, it is important to note that this reduction is relative to Record high levels of the beginning of the decade. The average real levels of both short and long interest rates in the U.S. in the period from the mid nineteen eighties to the end of the century were more than twice the levels of the 1950s and 60s.[36]

The American economy resumes its growth after 1983 and in 1984 receives a substantial demand stimulus due to a large increase in military expenditures resulting from president Reagan's strategy of trying to defeat the Soviet Union through renewed pressure in the arms race.

THE STABILISATION OF THE FLOATING DOLLAR STANDARD (1985-2004).

- *Low Volatility and Retaking the Leadership*

In the nineteen fifties and sixties the U.S. had higher unemployment rates and lower rates of growth than the other advanced capitalist countries. In spite of the greater volatility of interest rates, Exchange rates and international commodity prices, since the 1980s the U.S.

Economy has grown consistently at higher and more steady rates than the other developed countries , keeping relatively stable the hierarchy

[35] See Baghli, Cette & Sylvain (2003) for data on the "u" shaped trend of profit margins, that fall in the 1970s and then recover and reach levels above those of the 1960s since the 1980s in the U.S. as well as in other industrialised countries. The authors also confirm econometrically the positive relationship between the path of profit margins and that of the real interest rate. For data that show that the increase in interest rates in the U.S. and other rich countries did not reduce persistently the profitability of the non financial sector see Abrena, Epstein & Power (2003) and Epstein & Power (2003).

[36] For the ironical empirical confirmation , made by orthodox authors, of the fact that policies of high nominal interest rates affect in the same direction the level of real interest rates even in the long run (invalidating the so called Fisher relation which neoclassics are so fond of) see De Long (1999) and Chadia & Dimsdale (1999). The latter also show that the levels of high real interest rates found in the U.S. and other central countries since the 1980s actually brought interest rates back to the historical levels typical of the period before World War II , further confirming the exceptionality of the "Golden Age".

of per capita income (given that the faster growth of population and the work force in America practically offsets the higher rate of economic growth). The unemployment rates in the U.S., significantly higher than in the Bretton Woods period have been since then much lower than the in other advanced countries (except Japan). At the same time the inflation rates in the U.S. have been low and not very volatile.

Thus, since 1980s, in the external front the U.S. has managed to contain the contestation of rival currencies or nation States, getting rid of both any time of balance of payments constraint and of the geopolitical necessity of fostering the development of the other developed countries and the periphery. In the internal front there has been a great and decisive change in favour of the property owning classes, both in terms of distribution of income and of power over the decisions of the State. [37]

In our view the great change in the relative performance of the American economy is intimately linked with these substantial changes in internal and external power relations, which also helps to explain the remarkable stability and persistency of this performance.[38]

- *Volker's Dilemma, the Plaza Agreement and the New Depreciation of the Dollar*

In 1985 the American government decided that the dollar had already revalue too much and decided it was time to start engineering a new

[37] For data on the changes in the relative American performance in terms o inflation, growth and unemployment rate see Garegnani & Lucii (2004) and Cesaratto, Serrano & Stirati (1999: 50). For data on the substantial fall in the variability of both inflation and growth rates of output in the American and other advanced capitalist economies after the first half of the 1980s see Martin & Rowthorn (2004). Note that many authors (such as Tavares Tavares, 1993) have argue, until not very long ago, that in the post Bretton Woods period the central economies would have become much more unstable and volatile , and also that the competitors of the U.S. and Great Britain would tend to have superior macroeconomic performance. The empirical evidence points towards the opposite trend of great macroeconomic stability in the central countries and of a better relative performance of the U.S. (and even Britain) already from the mid 1980s.

[38] For Garegnani (ver Cavalieri, Garegnani & Lucii (2004)) this different performance is linked to the fact in the U.S. the internal power conflict had already been substantially "resolved" in the 1980s, whilst in many other advanced capitalist countries the fight against the Welfare State and the power of the working class is still going on. This would render unnecessary the continuation of the use of mass unemployment to ensure "stability" in the U.S. , differently from the other countries were there is still more conflict. For Pivetti ,while in Europe it is common to justifiy conservative economic policy in terms of a presumed loss of capacity of of nation states to do autonomous economic policies , " financial orthodoxy and budgetary balance represent in fact the last worry of the american governments : growth is their foremost objective , in a country of ilimited sovereignity as the United States, is the fundamental condition for the internal political". (Pivetti, 2002: 3 [our translation]). See also Medeiros (200?b, in this volume).

depreciation of the dollar . However, at the same time that the U.S. wanted to reduced its interest rate to induce an exchange rate depreciation,

The authorities wanted to keep relatively high real interest rates as a central part of the new "dear money" stance of monetary policy inaugurated by Volcker in 1979.

The way out of what we could perhaps be called "Volcker´s dilemma" was to make an agreement with the main industrialised countries which became known as the Plaza Agreement in which the U.S. managed to ensure, among other things, that the interest rates of the other countries would remain above the American rates in a way in which allowed the dollar to be devalued whilst keeping relatively high domestic real interest rates.

The agreement marks the beginning of a period of almost ten years in which the dollar devalued in almost 50% (in nominal terms) against the currencies of its main partners. This new dollar depreciation was successful for the U.S. and helped to improve the foreign competitiveness of American industry. At the same time the appreciation of the other currencies had serious negative repercussions for the other countries , being quite disastrous (coming as it did together with the external opening of the financial sector , also as a result of American pressure) for Japan.

The depreciation of the dollar after the Plaza agreement showed how much the other industrial countries were less and less willing to resist "cooperating" with the U.S. in changes in the international economy that clearly benefited mostly the American interests.

In the mid 1980s, in spite of the sharp fall in world inflation and of oil demand, OPEC was trying to prevent the nominal and real price of oil from falling too quickly, particularly through Saudi Arabia's efforts to restrict its supply.

In 1985, with the end of the Iran-Iraq was and the ensuing increase in supplies , Saudi Arabia's spare capacity in oil production reached unsustainable levels, near 80%. This led this country to give up its supply restriction policy and led to a price war that cut dollar oil prices by half by 1986.

After that, pressure from other OPEC members and from the U.S. [39] on Saudi Arabia resulted in the reestablishment of coordination in the oil market and made prices go back to levels closer to those which were compatible with American strategic energy security policy.

Indeed this policy has as one of its main directives to avoid that the oil prices remains for long below the cost of oil production in American soil, setting thus a floor for the international oil price.

- *The Soft Landing of the Dollar*

[39] Rutledge (2003).

The great depreciation of the U.S. dollar in the period 1985-1995 happened together with a substantial trend of falling oil and international commodity prices. Inflation in the U.S. also continued its downward trend.

This experience allowed us to observe that the inflation in the U.S. has became very little influence by the dollar exchange rate depreciations. In the first place this is because a good part of American imports consists of commodities and oil which are negotiated in international markets and whose prices are directly quoted in dollars. The prices of these commodities are very much affected, in the short run, by the growth of the American and world economy and by the level of American interest rates, but contrary to what many people thought, no doubt influenced by the historical precedent of the other major depreciation of the dollar in the nineteen seventies, these prices are not affect directly by the depreciation of the dollar[40].

Besides that, even in the case of the differentiated goods imported from other industrialised countries whose prices are not denominated in dollars, and which dollar prices, in principle, tend to go up when the dollar goes down, the impact n American inflation has been quite small, in spite of the large increase in the American propensity to import since the nineteen eighties.

On one hand we do have, even for these differentiated products that are not standardised traded commodities the actual pass-through of dollar devaluations to prices in the American market has been only partial. A considerable (and apparently growing fraction) of the prices of these goods have kept their dollar prices unchanged when the dollar is devalued.

This seems to be due to the fear of exporters of losing shares of the American markets to products of suppliers from other countries, given that very seldom the dollar is devalued in the same proportion in relation to the different currencies. This phenomenon appears to be gaining importance since the mid 1980s to the present day, for the increasing openness of American industry to imports has been coming together with the establishment of a chain of suppliers (often owned by American multinational firms) in developing countries, particularly in Asia, whose nominal exchange rates are reasonably stable relative to the U.S. dollar for long periods of time.

For these reasons, dollar depreciations, in general, generate rather small cost shocks in the American economy and seem to have more the

[40] Parboni (1981) and Schulmeister (2000) believed in this relation between dollar depreciation and commodity prices. The latter has difficulties explaining what happened in the years of the great dollar depreciation from 1985 to 1995 and appeals to the "collapse of OPEC" as an ad-hoc justification for the absence of this relationship in the data for this period.

effect of increasing the growth of American exports than of reducing the growth of imports.

However, even taking into account all these factors, there is still the question that, in the nineteen seventies and in the beginning of the 1980s, the respective dollar depreciation and appreciation did have some effect of, respectively increasing and decreasing inflation whilst since then these changes do not seem to be having almost any effect.

Even more mysterious seems the fact that substantial supply shocks as the increases in dollar commodity prices of 1986-7 and 1994-5 had no significant effect on U.S. inflation (the same curious thing has happened to more recent increases in oil prices that also had little inflationary effect)

The answer to this puzzle appears to be in the fact that, as we have seen above the "real wage resistance" in the American economy has been quite substantially reduced since the first Reagan administration, something that by itself makes that any inflationary shock (whether external or internal) ends up having temporary effects but nearly no persistent effect on inflation rates. Real wages in the U.S. have become much more "flexible" downwards both in response to temporary shocks and to permanent distributive shifts.

- *Robert Rubin and the Appreciation of the dollar (1995-2000).*

In 1995, Secretary of the Treasury Robert Rubin, in the name of avoiding a global financial crisis outside the U.S., managed to make the Clinton administration decide to change the direction of the external value of the dollar (see De Long & Eichengreen, 2001).

The biggest worry seems to have that the Japanese yen, by getting ever stronger relative to the dollar, was taking Japan to a unsustainable financial situation, not only by the growing loss competitiveness of Japanese exports but mainly because the yen value of the large external assets of Japanese banks and firms was falling continuously, what aggravated the domestic financial and banking crises and the economic stagnation of the country.

Besides that, at the same time, Europe was going towards the Euro, and the overvaluation of European currencies meant falling growth rates of exports to outside the region. This combined with the contractionary domestic fiscal policies following the absurd rules of the Maastricht treaty was bringing the economy to a situation that put a smooth transition to the single currency at risk.

The appreciation of the dollar was made through the creation of a positive differential between nominal interest rates in the U.S. relative to Europe and Japan. In fact the interest rates in the U. S. remained above the others until the end of the century and the dollar increased its value

continuously. The American interest rates held above those of the others once again attracted a large foreign capital inflow. The great boom in the American stock market that started in 1995 stimulated even more the capital inflows in search of capital gains. These inflows of foreign capital by their turn increased even more the "irrational exuberance" of the stock market creating a vast speculative bubble in which share prices reached record levels.

At the same time, the spectacular capital gains generated by the stock market bubble, in particular in the NASDAQ market for shares in hi-tech firms created strong interests against any increase in the American interest rate. The chairman of the FED himself, Alan Greenspan, which some years before had warned against the "irrational exuberance" of the American stock markets, started to justify the fact that the FED was not raising interest rates, in spite of the decrease of the unemployment rate below the level that supposedly eventually would accelerate price inflation by making references to a "New Economy" which would allow higher rates of non inflationary economic growth.

Private non residential investment, that was growing along with the economic expansion, started to accelerate disproportionately in the sectors linked to the "New Economy" (Internet, Telecoms, Computers) when the availability of very cheap finance m through "venture capital" schemes helped to diffuse throughout the markets absurdly rosy expectations of the expansion of these sectors in the future. This increase in private productive investment share, which was soon to become unsustainable, accelerated the growth of aggregate demand and of the economy.

In 1998, in part as a result of the Russian crisis (on the side of supply) coming soon after the Asian crisis of 1997 (in the side of demand) there was another collapse in the international oil price. The American government , once again, directly acted by exerting pressure on Saudi Arabia nudging it towards more coordination with other OPEC members with the purpose of not only moving to pre crisis price but instead of actually forcing the market towards a permanently higher oil price. This increase was seem as essential to make the international oil prices compatible the new production costs of the American domestic oil industry, which have been increasing due to new regulatory and environmental costs and the American decision to increase the exploration of oil in Alaska (Rutledge, 2003).

These efforts have in the end been quite successful , and more recently (already in the administration of the younger George Bush) the U.S. is giving continuity to this price support policy , making use also of a substantial increase of oil purchases to fill up the reservoirs of the governments strategic petroleum reserve.

The strategy of recovering and increasing the relative price of oil worked and there was a large increase in international oil prices in 1999-2000. This increase that has later shown to be quite persistent ended up being entirely absorbed by lower real wages without any great impact n American inflation showing, once again, how much "inflation inertia" and "real wage resistance" has been reduced in the U.S. . . .

In any case the fast growth of aggregate demand, the fall in the unemployment rate to the lowest levels seen since the 1970s and the modest and temporary acceleration of inflation connected with the rising oil prices made the Fed start increasing again nominal interest rates.

This small interest rate increase seems to have signalled that it was time to realise the gains on the stock market and this movement end up being sufficient to pop the NASDAQ bubble, which quickly collapsed. The market suddenly took notice of the large and unsustainable spare capacity that was accumulating at the high tech sectors. Private non residential investment fell quickly and significantly and the economy entered in a recession for two quarters.

- *The Growing External Current Account Deficits.*

Over this period of dollar appreciation and accelerated growth of the American economy, the current account deficits of the U.S. have grown very fast reaching 5% by 2002.

However, in the current floating dollar standard, the growing current account deficits do not impose any balance of payments constraint to the American economy. As the dollar is the internationally accepted means of payment, practically all American imports are paid in dollars. This also means that practically all external American liabilities are denominated in dollars. As the dollars are issued by the FED it's simply impossible (as long as dollars are accepted as payment for imports) that the U.S. will run out of resources to honour its "external" commitments. Besides that, naturally it is the FED that directly determines the basic short term dollar interest rates, while the long term dollar interest rates are completely dominated by the market expectations of the future course of the FED´s rate.

Therefore as imports and the external debt of the U.S. are in dollars, the U.S. is in the peculiar position of determining unilaterally the rate of interest that is paid on its own external debt.

As the American government bonds, whose yields are regulated by the FED, are the most liquid dollar financial asset it they naturally also are the most important reserve international asset of the international financial system (Serrano, 2003).

Another consequence of the fact of that American external liabilities are denominated in dollars is that, when the dollar is devalued in relation to the currency of another country, those who suffer capital losses are the creditors, the owners of these assets instead of the U.S.. Moreover, as we have seem above, even a large dollar depreciation has very small effects on the U.S. inflation , while the inflationary impact of an exchange rate depreciation of other currencies is much greater given the fact that oil and commodity prices are set in U.S. dollars.

These asymmetries generated by the role of the dollar as the international currency have been thoroughly confirmed by the facts of the last few years. In 2001 the American recession had already started with the decrease of private investment due to the excess of productive capacity that was rapidly installed in the high technology sectors of the "new economy" during the NASDAQ bubble, when the September 11 terrorist attack took place.

The American policy answer to the crisis was fast and drastic. The basic interest rate was **reduced**; there was an enormous coordinated injection of liquidity in the international financial system by the FED, together with the central banks of the rich countries. There was also a rise in public spending, tax cuts, government financial help for the especially jeopardized sectors as airlines and insurance companies, etc.

All these measures certainly avoided the deepening of the recession and the disorganisation of the financial system. Just after the terrorist attack there was naturally a tendency in the international financial markets for "flight to quality" due to the increased perception of risk and uncertainty. This was worsened by the initial fear that the "war against terrorism" would end up triggering greater supervision and control of international capital flows with the aim of combating money laundering channels and locating the financial sources of the terrorists' funds.

For our purposes here what is important to notice is that this "flight to quality" of the market was a run **for the dollar** and not from the dollar, despite of the interest rate reduction, more than confirming the role of the dollar as a store of value currency of the capitalist world economy. It is to the dollar that the market runs to at moments of crisis, even when the crisis, as in this case, occurs in New York, at the core of the US dollar financial system.

The damage control and expansionary measures described above were already beginning to work by 2002. However, the scandal of ENRON and of the other big companies that were caught falsifying their balance sheets ended up bursting the stock market bubble. Until then, with the FED's help, the overall stock market bubble had survived not only the collapse of the NASDAQ bubble but even the terrorist attack.

Since the dollar was being kept appreciated mainly by the foreign demand for shares negotiated in the American stock market and the FED was already

quickly reducing the American interest rate (by much more than the other rich countries), it is only natural that the dollar started then to depreciate.
However, the result of this recent foreign capital outflow from the US and of the depreciation of the dollar has been the continuous reduction (instead of an increase) of American interest rates. These interest rate decreases have mitigated the financial losses of the heavily dollar indebted American firms and workers and has also has helped to keep demand growing both in the markets for real estate and for durable consumption goods.
This confirms that the US simply does not need those external capitals flows to finance its external current account deficit. The American external deficit continues to be automatically financed at the moment in which the transactions that generate this deficit are denominated and paid in the American national currency. Which other country that has a stock market crash and an outflow of external capitals and answers by **reducing** its interest rates?
In 2003/4 although the dollar continued tending to devalue, some countries - especially in Asia, as Japan and China among others - have been doing everything they can to avoid or contain the appreciation of their currencies relatively to the dollar. On the one hand, these countries do not want the increase of the dollar costs of their exports, generating either lower profitability or lower market share for their products in both the American and international markets. Moreover, the appreciation of the currencies of these "surplus" countries that hold a great amount of financial assets in dollars would bring big balance sheet losses for the local companies and financial systems. Because of that, the central banks of these countries are letting their external reserves in dollars increase continually in the attempt to avoid the appreciation of their exchange rate rates.
Given this, if there was any real basis for worrying about the size of the American external deficit, the American government should be commemorating the fact that although the private agents have "run away from the dollar" in recent times, the governments of the Asian countries are helping to minimize the depreciation of the dollar and finance the enormous American current account deficit, avoiding thus the "dollar crisis".
But, what has occurred in reality was simply the exact opposite of this. There has been growing (and not very subtle) American diplomatic offensive pressuring the Asian countries to let their currencies appreciate. The pressure on China to abandon the fixed exchange rate and to revalue the Yuan (to which they finally began to yield in 2005), in particular, has been very strong and there is growing American official accusations that the Asian countries are "protectionist", follow "mercantilist" policies and practice "unfair competition". The reason for this pressure seems to be very simple: at that moment the American priority was to revive the domestic economy. The depreciation of the dollar was in the interest of the U.S.

government in order to increase exports and to reduce the American imports to help the domestic economic recovery. The Asians were seen as going against this plan when they avoid the appreciation of their currencies. This last example shows how the American government is not even slightly worried about the depreciation of the dollar causing any problem, let alone a "crisis".

The recent recovery of the American economy, with the dollar being devalued and growing fiscal deficits has many parallels with the situation of the mid 1980s. At that time many analysts were sceptical about the possibility of this policy mix to work. Once again, there are a large number of people betting on the possibility of the end of the American leadership and of the dominance of the dollar or on a serious world crisis or in both things. This a quite curious position as, as we have seen above, nothing of the sort happened in the 1980s. In spite of the fact that the recession in the beginning of the Exist century has been historically one of the mildest (Ian spite of the various shocks described above) many annalists insist that, this time, the situation of the American economy is of much greater fragility.

One argument that has become quite fashionable, and is used by economists linked to the American Democratic Party, is that this time the public deficit and the government debt are at UN unsustainable path. Another argument is that the financial fragility of the American private sector is much greater this time and that growth is only being sustained by means of an artificial bubble fuelled by credit, this time linked to real estate prices. Finally, there is a third argument according to which the American external current account deficit (once again) and therefore the net American external liabilities are in an unsustainable path which, this time will lead to a final dollar crisis. Let us examine more closely this three arguments.

Minsky against the Minskyans?

Having their fears of an American crisis detonated by the growing external current account deficits been proven false by the recent facts , many analysts turned to the argument that the American fragility lies in the problem of the public deficit and of the government debt that would be in an unsustainable path.

In their best version, the argument is that the chronic external current account deficits represent massive aggregate demand leakages in the circular flow of income of the American economy. These leakages end up requiring, in order that the economy grows at rates that generate acceptable levels of unemployment in a context in which the private sector presumably would stop having financial deficits, growing

Compensating public deficits[41]. These public deficits would be bringing the American public debt to an unsustainable path in which, on present trends, the debt to gdp ratio quickly would reach "unacceptable" levels.

This argument seems to U.S. to be extremely weak. In the first place, it should be evident that the American government is not suddenly going to get out of money to pay its debt, if one day public debt ratio reaches this mysterious level which is deemed to be "unacceptable". Moreover, these analysts have not shown explicitly what kind of assumptions is being made to argue for the strange conclusion about the explosive debt trajectory.

In fact a high government deficit can only generate a growing public debt that grows without limit relative to gdp of the real rate of interest paid on this debt is higher than the growth rate of the economy. Not only this condition has not been observed in the American economy in the last few years but also there is no good reason to believe that the U.S. government, which has an unequal degree of freedom compared to any other country of the world in terms of the power to set unilaterally its interest rates, will allow this instability condition to hold for prolonged periods.

Turning to the argument about the financial fragility of the American private sector it would be interesting to start by recalling the lessons o Hyman Minsky, an author who is very admired by these analysts as a theorist of the financial instability of modern capitalism.

Minsky argued that the private sector of the American economy tended to grow by means of speculative bubbles of asset valorisation. The expansion of consumption and of private residential and non residential investment tended to generate endogenously ever more fragile financial structure. This is part was a result of the "herd instinct" of optimism that led to market conventions and expectations which underestimated the actual risks. Moreover there was the growing leakage effect that taxes and imports had on the growth of the mass of realised profits of the firms. These leakages, by making retained profits grow by less than private corporate investment led to an increasing dependency of productive firms in relation to the financial sector. In these conditions of growing financial leverage of firms, any new event that caused a sudden revision of expectations could detonate a crisis.

Although some fair criticism can be levelled at this financial theory of business cycles[42], what is of import to us here is that Minsky himself argued that, in spite of this inherently unstable financial dynamics of the

[41] The main exponents of this view lately have been Wynne Godley and his followers at the Levy Institute in the U.S. and at the Cambridge Endowment for Research in Finance in Britain (see especially Godley & Izurieta, 2004).

[42] This theory shares some of the problem common to most kaleckian investment fuctions such as those pointed out by Petri (1993).

private sector, the American economy **did not** run the risk of entering again in a serious prolonged crisis as the great depression of the 1930s. This was the case simply because fiscal and monetary policies would not allow it to happen. On one hand, as Minsky pointed out and as American history shows clearly the American government can and (whenever it wants does) use expansionary fiscal policy both in terms of automatic stabilisers and more actively with tax cuts and specially increases in government expenditures (and military expenditures in particular) to take the economy out of a recession. In fact the only deeper post war recession was that of the early 1980s when contractionary policies were used as a weapon on purpose to bring down inflation and weaken the bargaining power of workers and of rival Nation States. Expansionary policies were quickly resumed as these objectives were being attained.

Besides fiscal policy that Minsky called *Big Government*, he also noted that the American government always played the role of lender of last resort, helping financial institutions that could generate systemic risks, lowering interest rates to help the refinancing of private sector balance sheets in order to avoid a debt deflation, etc. Thus, Minsky´s answer to the question "Can it happen again" ("it" being the Great Depression) was simply: no! Minsky understood very well that the American State "learned the trick", as Kalecki would[43].

- *Hicks and the American external deficit: weakness or strength?*

Let us now turn to the last argument, about a possible dollar crisis that could occur if the American current account deficit starts growing at an undesirable rate.[44]

Many years ago Hicks (1989) was already asking himself if the role of international money could be adequately played by a "weak" currency such as the dollar- "weak" only in the specific sense of being the currency of a country that has a chronic tendency towards current account deficits. For us it will be useful to distinguish between three different aspects of this central problem.

The first aspect can be summarised in the following question: is it reasonable to assume that other countries will stop accepting dollars as payment for exports to America in the near future? As the U.S. still remains the biggest market of the world for goods and services, not accepting dollars would mean in practice, to be excluded from

This market – unless all other countries that export to the U.S. refused to accept dollars at the same time, in coordination. Moreover, recent official estimates shown that at least one third of the American current

[43] See the essays collected in Minsky (1982).
[44] This section draws heavily on Serrano(2003).

account deficit is in reality generated by exports to the U.S. of American multinational corporations. These firms (for many obvious reasons) will not refuse payments in dollars, and to that, most certainly we could add a number of their local suppliers abroad. In any case it is unlikely, given the current American military superiority that the U.S. will not find developing countries that are willing to accept dollars as payments for oil and other raw materials. Therefore, it is very likely that the U.S. continues, in the near future, to pay for its imports directly in dollars, something that, we insist, s automatically provides the financing of its current account deficit.

Under present conditions only a great bout of inflation in the U.S. could substantially reduce the role of the dollar as international means of payment, since fit would weaken substantially the purchasing power of the dollar in the markets for goods and services both domestic and international. This could begin to make convenient the making of transactions with other currencies.

The second aspect of Hicks problem brings us to another question: what if the current account deficit grows too much? Usually, the accumulation of current account deficits leads to an exponential growth (at compound rates) of the net income payments abroad. This has not yet happened in the U.S. basically because the rate of return of American assets abroad has been substantially higher than the rate of return of the American external liabilities. But it is quite possible that could happen in the future.

In any case, contrary to other countries when most (if not all) of the external liabilities are denominated in other currencies, the U.S. has the power to reduce the financial burden of its “external” debt merely by unilaterally reducing its domestic interest rates. And a reduction in American interest rates would tend also to lead to a dollar depreciation which, by its turn, would help reduce the trade deficit.

This brings us to the third aspect of the dollar problem that can be summarised by the following question: what would happen if for some reason the residents of other countries began to sell their dollar? If the private agents and/or the government of a single country decided to sell a large quantity of their dollar assets, the currency of this country would suffer a drastic appreciation relative to the dollar. But this would probably mean that this country would lose market share in the exports markets both in the U.S. and in other international markets. Besides that, a great Exchange rate appreciation in a country that is a net creditor of the U.S. could easily lead to a domestic financial crisis, since the value in terms of local currency of the external assets of the holders of the American external debt would be greatly reduced. It is then not at all clear why it would be in the interest of the State, banks and firms of this country to allow such appreciation to happen.

The analysts that predict a dollar crisis due to the sale of American assets by foreigners seem to forget that something close to this has already happened in reality, when Japan entered its period of crisis after the long appreciation of the yen. And this is precisely what both China and Japan are trying at all costs to avoid, as we have seen above, in the first few years of the twenty first century[45]. Meanwhile, the countries using the Euro protested because they did not manage to do the same as the Asians.

It is important to note that the depreciation of the dollar relative to a single currency, even by a substantial amount, tends to have no significant effect on international dollar prices or in American inflation, precisely because other countries would use this as an opportunity to steal market shares of the export markets of the revaluing country.

Therefore, only a large, collective effort of selling dollar assets, reasonably well coordinated among many countries could possibly lead to substantially higher international dollar prices and inflationary pressures in the U.S., something that looks quite improbable under current geopolitical conditions. Even then, only if the impact of this possible external shock detonated a more persistent and chronic inflationary process in the U.S. and in the international dollar prices it would be probable that the dollar could begin to lose its present role. However, as we have seen above, the inflation the U.S. can only accelerate persistently if, by some means, workers go back to the practice of reacting to the real wage losses of inflationary shocks by quickly obtaining compensating nominal wage increases, something that would require a substantial change in the bargaining power of the working class in America.

Therefore, we must conclude this long story by noting that, given the state of power relations both in the internal front (which concretely manifest themselves as low "real wage resistance" and inflationary inertia) and in respect to the rest of the world (in economic, political and specially military terms), the floating dollar standard will certainly be around for a while, until more structural changes happen in these power relations. And Hicks, after all (once again) got it wrong. In reality the dollar can be "weak" precisely **because** it is the international money.

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[45] Note that formerly quite orthodox authors, such as Ronald Mckinnon (see Mckinnon & Schnabl, 2004) have understood well this aspect of the new system (see also Dooley Folkerts-Landau & Garber, 2003). For a critical analysis of Mckinnnon´s views see Medeiros (2005b, in this volume).

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