Nixon, the Dollar, *and the* Emerging New Money Revolution

By Harold James

The emergence of weightless globalization.

Richard Nixon in 1971 embraced a mendacious narrative of economic nationalism that has haunted, and damaged, the United States ever since: it shaped a new approach to money, without dethroning the U.S. dollar. Today, protectionist currency politics are also rampant; but rapid technological developments in money and payments technology are generating a radically transformative rethinking of money.

Nixon's announcement on August 15, 1971, was, as he intended, game-changing—but not at all in the way that Nixon imagined or promised. He started his televised address with the observation that: "Prosperity without war requires action on three fronts: We must create more and better jobs; we must stop the rise in the cost of living; we must protect the dollar from the attacks of international money speculators."

The American president did indeed, eventually, end the long war in Vietnam, perhaps the prime driver of the increasing American malaise. But instead of creating more jobs, the end of the par value system (Bretton Woods) produced a decade in which unemployment soared and manufacturing jobs were lost; inflation increased dramatically rather than falling; and international capital markets (also known as international money speculators) had a bonanza. Far from being repelled as a result of government action, they took over the American economy.

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It wasn't just a bad prophecy or prediction. Nixon's speech was full of a dishonesty that was starkly apparent at the time. The president assured: "Let me lay to rest the bugaboo of what is called devaluation. If you want to buy a foreign car or take a trip abroad, market conditions may cause your dollar to buy slightly less. But if you are among the overwhelming majority of Americans who buy American-made products in America, your dollar will be worth just as much tomorrow as it is today. The effect of this action, in other words, will be to stabilize the dollar."

Nixon was uncannily echoing another persistently mendacious political leader, Britain's Harold Wilson, who had told the British public after the 1967 devaluation of sterling that: "From now on, the pound abroad is worth 14 percent or so less in terms of other currencies. That doesn't mean, of course, that the Pound here in Britain, in your pocket or purse or in your bank, has been devalued." That pronouncement too had been subjected to immediate ridicule, as the effect of devaluation on import prices was even more apparent in Britain, as a smaller and more open economy.

There were also parallels in the repercussions of the 1967 and the 1971 currency moves. The devaluation of the world's second reserve currency, the British pound, set the stage for increasing nervousness about the future of the dollar as the world's central reserve currency.

The Nixon speech was a rejection of any multilateral solution of the exchange rate issue—the International Monetary Fund had been preparing recommendations on a new structure of exchange rates, but it was ignored. It also set about the demonization of capital markets: "Now who gains from these crises? Not the workingman; not the investor; not the real producers of wealth. The gainers are the international money speculators. Because they thrive on crises, they help to create them."

As the crisis of Bretton Woods was building up, the Canadian economist Robert Mundell prepared a remarkable essay, with three big—and for the late 1960s completely surprising—predictions. They turned out to be spot on. The dollar would remain the world's leading currency for the foreseeable future; Europe would get a single currency; and the Soviet Union would disintegrate.

Mundell's trinity proved a much more successful act of prophecy than Nixon's hope for job creation, no inflation, and curtailing international speculation. The prophecies were interconnected. It was the new dynamism of the capital markets and of American banking (operating increasingly offshore) that ensured the continuing preeminence of the dollar. Worries about the international position of the dollar, especially when the currency was weakening, in the late 1970s, the late 1980s, and the early 1990s, provided a decisive push to Europe to institutionalize closer currency cooperation. The need of the Soviet Union to access international capital markets in the late 1990s accelerated the process of dissolution.

The immediate effect of Nixon's price controls was to encourage more consumption and more imports. Eventually there were shortages, especially of heating oil in the winter of 1972–1973. The chronology of descent into scarcity matters because a great deal of the mythology of the 1970s arose from the claim the rest of the world—in

History Lesson

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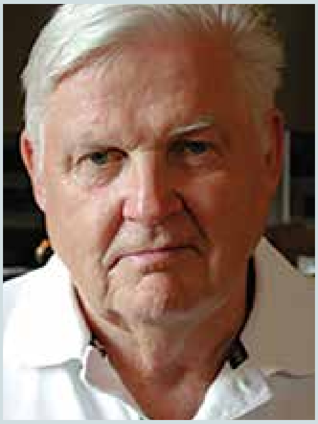
—*H. James*

U.S. Treasury Secretary
Janet Yellen



The Remarkable Mundell Essay

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Nobel Laureate **Robert Mundell,** *1932–2021*

particular the oil producers, but also other commodity suppliers—had abused their position. Americans continued in Nixon's vein: blaming foreigners for a domestically produced disorder, driven by a combination of loose fiscal policy and politically motivated monetary policy. In reality, of course, the rest of the world was responding to developments driven by the United States—and by the many other western countries that had embarked on the same course of self-confident expansion.

There might have been a new stable multilateral system of exchange after the December 1971 Smithsonian meeting, but Nixon was unwilling to take his feet off either the monetary or the fiscal pedals, as he was fixated by the 1972 election and the need to maintain an economy running hot in order not to risk election defeat. Instead, a non-system, to use the neat phrase of the late economist John Williamson, emerged.

However, the center of the non-system, the dollar, is gradually eroding. We have come a long way from the unipolar moment of the 1990s. Doubts about the dollar were raised by another unpopular and ill-judged war, the 2003 invasion of Iraq; by another financial crisis in 2007–2008; and by the increasing weaponization of the dollar as an instrument of geopolitical coercion. Juan Zarate, one of the architects of the specific plan to use financial sanctions in the 2000s, correctly noted that it was a highly successful instrument against North Korea, but that it would be less effective and possibly counter-productive when applied to more internationally connected economies such as Iran or Russia.

After the bitterly divisive election of 2020, with the very tight Senate race and the prospect of a possible blowback in 2022 (a repeat of Obama's 2012 "shellacking"), the administration is making a calculation analogous to the Nixon calculation in the lead-up to the 1972 election. Fiscal and monetary stimulus can be pushed simultaneously on a scale unprecedented in peacetime because of the unique position of the dollar, the only currency to have a true monetary sovereignty.

The centrality of the United States to everyone else's discussions of global governance may look to some optimists in Washington as if it must inevitably persist, and that the worst that could happen from a resurgence of inflation would be an episode of dollar depreciation followed by rebalancing, similar to that of the Carter presidency in the late 1970s. After all, the United States provides two common goods that everyone still, for the moment, needs—the English language as a common medium of expression, and the American dollar as a common medium of exchange. Will those advantages endure even after the relative decline of America's share in the world economy,

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the rise of big new economic powers, the fragility of the international order, and the increased push (even with new administration) to disengage from the world?

Both language and dollar are now under threat. The past years have seen enormous advances in automatic translation.

And what about money as a translator of wants and needs? There are already warnings: the 2020 liquidity strains in the Treasury market, the weak foreign demand for Treasury securities. The long preeminence of the dollar is under challenge, but not primarily from other currencies—though both the euro and the renminbi may well be bolstering their attractions as claimants to the throne of the dollar. The national era in money is drawing to a close at the same time as a technological revolution gives radically new methods of addressing the problem of a cross-border monetary language.

One consequence of the new possibilities is the unbundling of the apparently solid historical link between money and monetary stability and government fiscal management. Experiments to tackle the economic fallout from Covid-19 through large central bank stimulus programs, promised for long time periods, risk a new vulnerability and raise inflationary dangers. It is likely that the world will demand a new monetary revolution; and at the same time, the means for that revolution is supplied by the way loose monetary policy pushes flows into alternative asset classes.

As money is unbundled into different functions, with new platforms of exchange, where is innovation most likely to occur? One prediction would be that the innovation would occur where states are weak and not trusted, and consequently state promises are not seen as highly credible.

In rich and well-developed industrial societies there is another logic. Where the promise of social cohesion means less, being able to separate peacefully into different groups may become a way of avoiding clashes and conflict. Currencies will establish communities, bound together by exchanges of information.

We will unbundle different aspects of our lives. Thus, Starbucks cards might be used as an international currency for luxury food products, or Apple music or Spotify plans/memberships for buying or selling sounds. It is also possible to imagine that the new digital ecosystems may be rebundled in new ways: excessive consumption of coffee or of sugars, for example, might be linked to alerts to medical service providers. And the willingness to use smart currencies might be linked to reduced health and life insurance premia (while correspondingly, an unwillingness would be penalized through higher prices).

New money may be ending the long period of dollar hegemony. Covid has accelerated that development, as in many other areas of life. It is making for more digital globalization, and less actual globalization, less movement of people and of goods. There is more information flowing—this is the ultimate weightless economy or weightless globalization.

The dollar's centrality was prompted by the global demand for a deep and liquid safe asset; and that centrality will only disappear when alternative safe assets emerge, backed in some cases by non-state providers. In the past, alternative safe assets dominated—when precious metals were the basis for currency issue. Even in the late twentieth century, nostalgic commentators looked back to that

The Nixon speech set about the demonization of capital markets.

era. The alternative is to think of currency as having a real collateral—in this particular case, information generated by the participants in a wide variety of overlapping communities.

The action of 1971 marked the final end of a commodity (gold-based) monetary order, and the beginning of a new world of fiat currencies, which the world's governments and central banks only learnt to manage effectively in the 1990s. We are moving to a new monetary order, with a sort of commodity base: information. The learning process of how to manage that new system may be faster than the tumultuous experiments of the late twentieth century, but it won't be easy. ◆