THE NIXON SHOCK

A 'Plain English Economics' Classroom Resource for Post-Primary Schools

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We left off at the end of WWII, with the creation of the Bretton Woods institutions to manage the global monetary order. The period between 1945 to 1971 is referred to as the 'Golden Age of Capitalism'. This is because wages rose with productivity. Also, governments needed revenue to rebuild after the war, so they needed labour. This meant that they had to listen to the demands of workers. Governments also taxed heavily (to increase revenue), including the wealthy, increasing equality. A benefits system was introduced in many countries. Capital was used for public benefit. From 1945 to approximately 1975, there was a huge growth in the middle class. Their purchasing power hugely increased and consumption shot up. This group could save, and could access capital (loans and assets) at a rate unprecedented in history.

But as the living standards of the middle class rose, their wages were not rising quickly enough to keep pace with the levels of consumption and with rising costs. However, unions and workers resisted and demanded higher wages. As a result, employers needed to raise prices in order to pay them. This is called the 'wage-price spiral'. Prices were rising in society (inflation) and economic growth was low. This combination is called stagflation, and it deeply worries governments, as it did the US government at the time.

In 1969, the US Federal Reserve realised that there were four times as many dollars in circulation as there was gold in reserves, as so much had been lent out, for example in the Marshall Plan to rebuild Europe after WWII. Inflation - an increase in the general price of goods - was beginning to take hold. This was combined with a trade imbalance: the US was importing more than it was exporting. The Nixon Administration was afraid that other countries were going to ask for gold and that the US wouldn't have it. They needed to devalue the dollar so that they could actually pay back what was lent, but they couldn't do this while the dollar was still pegged to gold.

On August 15th1971, Nixon went on television and very clearly articulated what had been decided. The dollar would not be backed by gold anymore. There would be a 90-day wage-price freeze in the US in order to lower inflation. And he imposed a 10% tariff on all imports, which would be removed only after there was a new international monetary agreement. The tariff on imports was to ensure that American-made goods would be competitively priced for American consumers.

Nixon said to TV viewers and the nation:

> **"Now, what is this action - which is very technical - what does it mean for you? 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."**

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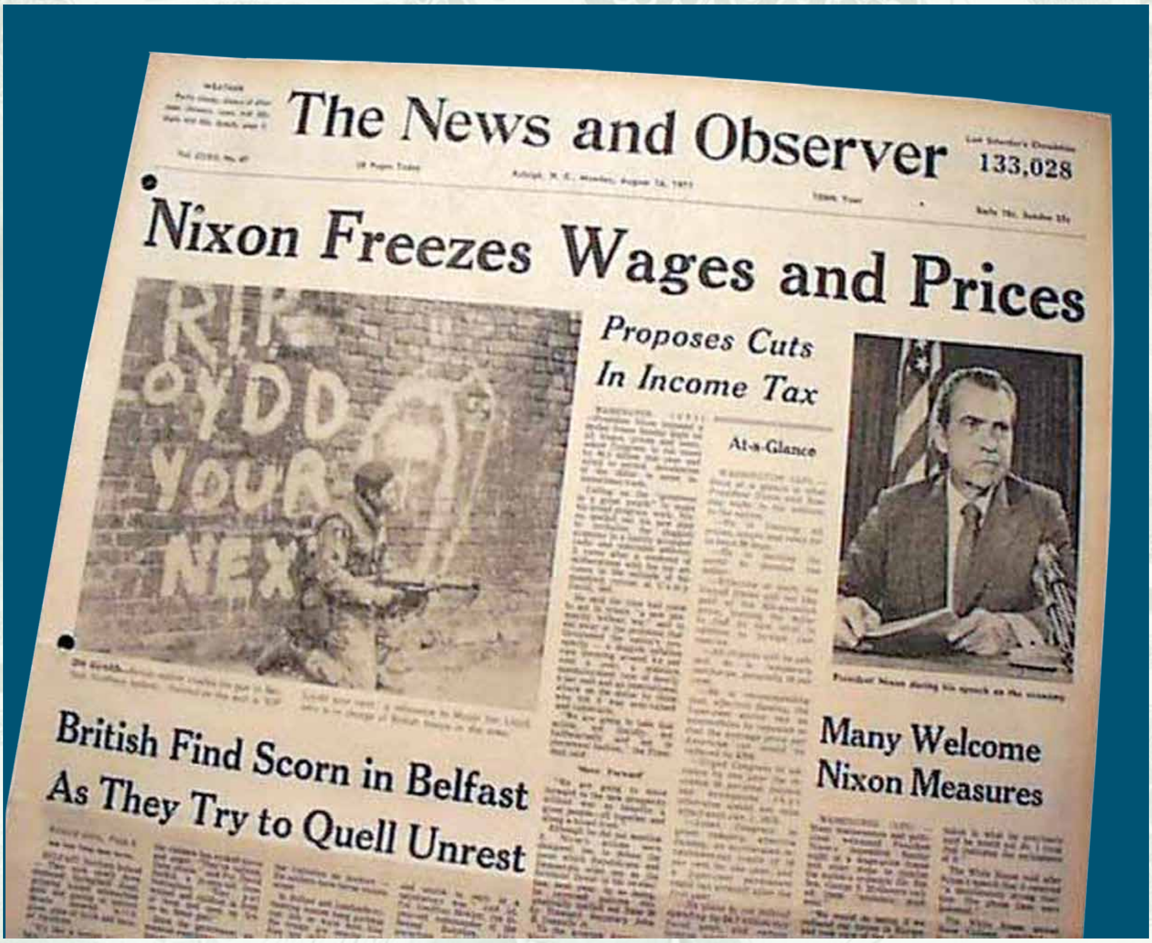
These new policies were called the 'Nixon Shock'. It put a gun to the head of all other countries to agree on a new way of running things, different to that which was agreed as part of the Bretton Woods Agreement. With the Nixon Shock, many politicians and governments felt that the United States had acted only in its own interests. The International Monetary Fund called for a meeting of the Group of Ten (G-10, at that time the ten wealthiest and most powerful nations) and this meeting decided on new international exchange rates, in what became known as the Smithsonian Agreement. This plan did not work, and today in the wealthy nations of the world we still have "floating currencies", or currencies that are not tied to gold or to another currency to maintain their value, but whose value depends on the market.



The News and Observer

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Nixon Freezes Wages and Prices

Proposes Cuts In Income Tax

At-a-Glance

British Find Scorn in Belfast As They Try to Quell Unrest

Many Welcome Nixon Measures

The Nixon Shock didn’t work as planned to stop ‘stagflation’ (the combination of inflation - rising prices - and low economic growth). As the value of the dollar was no longer tied to gold, but was now a floating currency, its value dropped in international markets during the 1970s. This meant that prices were higher for consumers in the United States.

The Nixon Shock brought an end to the fixed currency system under the Bretton Woods Agreement, and the Agreement was officially abandoned in 1973.

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