ESSAY APRIL 29, 2025

America's Implicit Defaults

BRUNO MEYERHOF SALAMA

Governments often find ways to pay the full amount without paying the full value, but there are limits to how long that can work.

THE UNITED STATES PRIDES ITSELF ON NEVER HAVING defaulted on its federal public debt. And in formal terms, that claim holds up: obligations have been paid on time, in full, and in the currency promised. That's no small achievement—and it sets the US apart from most other countries, as if Hamilton's dictum still quietly defines the nation's approach: "States, like individuals, who observe their engagements are respected and trusted."

But that's not the whole story. The US has found ways to erode the real value of those payments without breaking the legal terms of its debt. This ability rests on a legal doctrine known as nominalism—the principle that a debt is satisfied by payment of the stated amount in dollars, regardless of what those dollars are worth in real terms. When value is eroded without breaching the formal terms of repayment—whether by inflation, devaluation, or internationally coordinated monetary policy—the real value of the obligation is reduced. Legally, it's not a default, but economically, it may be.

Nominalism in the US and Beyond

Nominalism is the law in the United States. Courts do not recognize inflation, devaluation, or purchasing power loss as relevant to the legal fulfillment of a financial obligation. With the exception of a limited issuance of inflation-protected securities (TIPS), US Treasuries are payable strictly in nominal dollars. The legal system requires only that the government pay what is formally owed, not what those dollars are worth in real terms.

In effect, nominalism serves as a mechanism of risk allocation: it assigns the risk of currency devaluation or inflation to the creditor. By treating nominal payment as full legal discharge, the legal system allows debtors to shift the burden of monetary instability onto those who hold their debt. It's like settling a lunch bill with exact change—after inflation has doubled the price of food. Legally, the amount is correct; economically, the creditor is left hungry.

The legal principle of nominalism exists in nearly every jurisdiction, but the ability to rely on it consistently depends not on doctrine alone, but on credibility. The US can do what others cannot—not because the law is different, but because trust is.

Where sovereign credibility is weak, the promise of nominal repayment offers little reassurance to creditors. The market demands legal safeguards: indexation (adjusting the value of obligations for inflation), currency clauses (tying repayment to a specific foreign currency), or foreign denomination (stating the debt in a non-local currency). In these contexts, the law may permit nominalism, but reality forces governments to go further, shifting monetary risk back onto debtors through legal design.

These dynamics are not confined to any one region. Greece's 2012 debt crisis, for instance, showed how the inability to devalue or inflate away obligations can turn fiscal stress into default and restructuring. Similar situations have arisen in places as diverse as Turkey, Ukraine, and Sri Lanka, to name just a few. Latin America, too, offers especially vivid examples of how legal systems adapt—or fail to adapt—to persistent monetary instability.

Brazil provides a particularly clear case. It issues a substantial portion of its public debt indexed to inflation or foreign exchange movements. This framework is not limited to government bonds. Brazilian private contracts —mortgages, leases, long-term loans—are often indexed as well, reflecting widespread legal accommodation for monetary instability. The legal system supports these structures through judicial enforcement of real-value protections, including inflation indexing in civil obligations and monetary correction clauses. Even wage negotiations often incorporate inflation expectations or indexation. Over time, Brazilian courts have embraced a hybrid approach—oscillating between nominalism and valorism depending on economic conditions and institutional priorities—in a legal system that formally purports to uphold nominalism.

Brazil is not unique in Latin America. In many countries, inflationary history, monetary instability, or a lack of institutional trust prevent governments from using nominalism as a reliable tool for stealth debt erosion. In Argentina, for example, a partially dollarized legal culture reflects a deep mistrust in the peso and in the state's capacity to maintain monetary stability. Contracts are often dollar-denominated or explicitly tied to foreign exchange rates. These legal adaptations reduce flexibility: with widespread indexation and dollarization, inflation is no longer a silent tool of debt erosion, and more overt forms of default become harder to avoid.

In more extreme cases, states have had to surrender their monetary sovereignty entirely. Ecuador and El Salvador, for instance, adopted full dollarization. In these cases, the lack of sovereign credibility was so severe that markets eliminated the very possibility of implicit defaults through monetary means. With no national currency to manipulate, these governments lost both the legal and policy means to erode obligations silently.

> The more often law is used as a tool of quiet erosion, the less invisible the mechanism becomes.

These workarounds all reveal the same truth in reverse: what the United States can get away with, others cannot. Because of its reputation as a reliable debtor—and the central role of the dollar in global finance—the United States can sustain a strictly nominal debt regime. That would be unthinkable for countries with weaker currencies or histories of default. Where the US can erode its obligations quietly, others must do so transparently—or not at all.

The Legal Foundations of Debt Erosion

For much of US history, the legal framework placed real limits on the country's ability to erode its debt. Gold clauses and convertibility norms limited monetary discretion and ensured that creditors received payment in real, not just nominal, terms. That changed decisively in the 1930s. During the Great Depression, Congress invalidated "gold clauses" in public and private contracts—clauses that would have preserved creditors' real returns. In *Perry v. United States* (1935), the Supreme Court admitted the government had breached its promise but concluded that creditors had been paid the nominal amount and were owed no remedy. With that ruling, the Court upheld nominal repayment as legally sufficient, and the modern architecture of implicit default took root. *Perry* marked the decisive moment when US courts upheld nominalism not just as a practical expedient, but as a constitutionally permissible foundation for public finance.

From that point forward, the United States continued to erode the real value of its obligations without violating their legal terms. The strategy evolved, but the legal principle remained intact. In 1971, Nixon unilaterally closed the gold window, ending Bretton Woods and breaking the promise of dollar convertibility to foreign governments. This was the closest the United States has come to breaking a legally binding promise to repay a debt. Under the Bretton Woods system, the US had a treaty-based commitment to convert dollars held by foreign governments into gold at a fixed rate. The Nixon administration's decision effectively disregarded that international commitment. Still, because there was no enforceable legal forum or remedy—due to sovereign immunity and the absence of adjudicatory jurisdiction—it remains debatable whether this amounted to a true legal breach. Economically, however, it changed the entire structure of global finance.

Policy Tools of Silent Erosion

The legal principle of nominalism enables a broader arsenal of policy tools aimed at eroding the real value of public debt. For instance, in the decades after World War II, the US government capped yields on Treasury bonds to keep interest rates low. As inflation rose, bondholders were locked into low nominal returns, repaid in dollars that had lost much of their purchasing power. The result was a transfer of value from creditors to the state. Inflation in the 1970s amplified this effect. Domestically, it meant that Treasuries issued in the low-inflation 1960s were paid back during an era of double-digit inflation, delivering negative real returns to bondholders. The inflation of 2021–23, although smaller in magnitude, followed the same legal logic: formal compliance with debt terms, even as rising prices eroded real value.

Beyond domestic inflation and interest rate caps, the US also employed externally coordinated methods to erode real debt burdens. The Plaza Accord of 1985 marked a qualitatively different strategy: a coordinated depreciation of the dollar, pursued through international agreement with key economic partners—Japan, West Germany, France, and the United Kingdom. Though framed as a currency policy, the effect was familiar: a significant decline in the dollar's value that reduced the real worth of dollar-denominated assets held by foreign creditors.

That logic continues to inform proposals today. One recent example is the so-called "Mar-a-Lago Accord"—a hodgepodge of proposals centered on a coordinated dollar devaluation, aimed at rebalancing trade and easing the real burden of US debt. These ideas range from an international agreement to weaken the dollar, to a US-led accumulation of foreign currency reserves, to more aggressive measures such as incentivizing foreign creditors to exchange their holdings of Treasurys—or even gold—for long-dated or perpetual US bonds. The most radical version contemplates taxing interest payments to foreign holders of Treasurys—a kind of "user fee" intended to discourage reserve accumulation altogether.

Despite their differences, each version of the plan rests on a shared premise: that the United States can erode its obligations through monetary strategy rather than legal breach. Like its 1985 predecessor, the plan would reduce the real value of US obligations without violating their formal terms. Whether such a strategy is practically feasible is far from certain. Unlike in 1985, the United States would today need to persuade countries that are not close allies—or only loosely aligned—to go along, making coordination more uncertain and politically complex.

Legal Form, Real Strain

Implicit default is not accidental—it's designed and expected. Not only in the US, but everywhere. But there are limits to this superficially noiseless system. Outside the US, those limits are often severe, sometimes even existential. Where institutional credibility is weak or inflationary history deep, stealth erosion through nominalism becomes harder to sustain. Governments in such contexts are constrained in their ability to raise debt and are often forced to index obligations, dollarize, or default outright. In some cases, inflation itself becomes so extreme that it ceases to be stealthy—more open rupture than quiet erosion. What the United States can do in silence, others must do in the open.

What distinguishes the United States is not that it avoids the strategy of eroding real obligations without breaching legal terms. It is that the US can deploy it under the cover of issuing the world's reserve currency—a position that ensures persistent global demand for its debt, even when repayment comes in eroded dollars. Implicit defaults are only possible for debtors who are regarded as trustworthy. The privilege of reserve status amplifies that trust: it allows the US to borrow in its own currency, on favorable terms, and in vast amounts—all while preserving the legal facade of full repayment.