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The multiple contexts of Bretton Woods

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Abstract This paper examines why so much debate about the structure of the international economy revolves around a conference held at Bretton Woods in July 1944 which was not immediately conspicuously successful. There was a unique confluence of contemporary contexts—in terms of trade policy, stabilization policy, and policies with regard to capital movements—that meant that prevailing ideas (especially the ideas of John Maynard Keynes) and the interests of the United States coincided. It was fundamentally a victory of the United States, but dressed up as benign multilateralism. A similarly unique combination of circumstances surrounded European efforts in the 1970s and was later to create, through the European Monetary System, a scaled-down version of Bretton Woods. The myth of Bretton Woods was created by a powerful retrospective interpretation or retrospective context that lent a golden halo to the whole exercise. In that sense our interpretation of a very specific historical event is inseparably intertwined with views of what happened *after* as well as *before* that event.

Key words: Bretton Woods, European Monetary System, international economic order, international cooperation, imbalances, capital movements, inconsistent trinity

JEL classification: E65, F33, F36, F55, F68

I. Introduction

Bretton Woods has become a powerful myth. It is the only instantly recognizable location of the series of conferences of the wartime coalition (the United Nations) held shortly before and after the end of the Second World War. Hot Springs (the conference in May and June 1943 that discussed food and agriculture) and Dumbarton Oaks (the meetings that sketched out a future international organization from August to October 1944) are easily forgotten; even the San Francisco conference (April–June 1945), that established the post-war United Nations system, is scarcely identifiable to any but the expert in United Nations history. By contrast, the United Nations Monetary and Financial Conference, held in July 1944 at Bretton Woods, New Hampshire, is still instantly recognizable as a view of the world.

This paper suggests that this view stems from a unique confluence of contemporary contexts—in terms of trade policy, stabilization policy, and policies with regard to capital movements—but also from a powerful retrospective interpretation or retrospective

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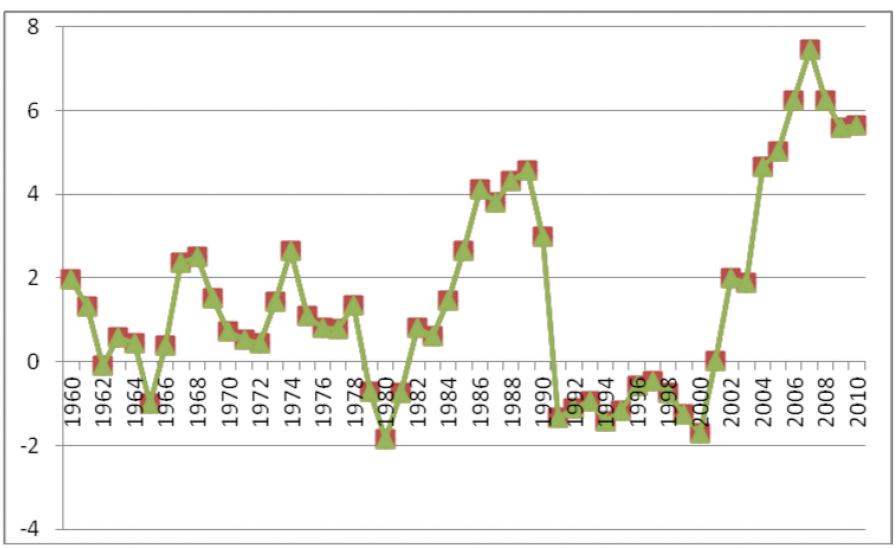
context that lent a golden halo to the whole exercise. In that sense our interpretation of a very specific historical event is inseparably intertwined with views of what happened *after* as well as *before* that event. In retrospect, the Bretton Woods order looks like a solution, not just to the question of post-war reconstruction, but to the problem of recasting capitalism in such a way that it would not permanently destabilize both itself and the international political and legal order. As Robert Skidelsky has recently reminded us, in consequence it has a continuing actuality (Skidelsky, 2009).

Any contemplation of the Bretton Woods has to begin with the godlike (the phrase is Lionel Robbins's, not mine) figure who presided over it.[1] Bretton Woods was about reconstruction, but not simply about reconstruction after a war or about trying to return to the pre-war order. The conference continued a debate about the appropriate form of an international economic order that had already started in the war, as a competition of contrasting systems. When in 1940 the German Minister of Economics, Walther Funk, presented a plan after the fall of France and at the height of German euphoria about a Nazi 'New Order', the British government asked John Maynard Keynes to prepare a counter-scheme. Funk had presented his plan as an alternative to the out-dated and discredited gold standard; Keynes insisted that any response could not offer reconstruction as it had been done after the First World War. He wrote that it would not be enough to restore 'good old 1920–1921 [the post-war slump] or 1930–1933 [the Great Depression], i.e. gold standard or international exchange *laissez-faire* aggravated by heavy tariffs, unemployment etc. etc.'.[2] He did not want the solution that the United States preferred, extensive trade liberalization, as that would simply open up other, less competitive,

Figure 1: German current account balance as a share of GDP, 1960–2010



Source: Deutsche Bundesbank.

[1] For Lionel Robbins' description of the 'godlike' Keynes, see Harrod (1972, p. 740); also Moggridge (1992).

[2] Funk (1940); van Dormael (1978, pp. 6–7); Gold (1984, p. 19); Moggridge (1992, p. 654).

economies to a renewed onslaught of the forces of depression. Bretton Woods was about reconstructing a system that had not been adequately reconstructed in 1919. But how could a world order, which had evolved rather than being created spontaneously, be negotiated by different powers that wanted to protect their national interest?

Keynes had a powerful reputation as a critic of counter-productive or destructive attempts at international cooperation: of the Paris peace conference of 1919, but also of the attempts to deal with depression in the early 1930s. In 1933, Keynes had commented on the abortive London World Economic Conference that a powwow of 66 nations could never be expected to agree. A workable plan could only be realized at the insistence of 'a single power or like-minded group of powers'.[3] In 1919, in *The Economic Consequences of the Peace*, John Maynard Keynes wrote plaintively (Keynes, 1919, p. 268):

> But if America recalls for a moment what Europe has meant to her, what Europe, the mother of art and knowledge, in spite of everything, still is and still will be, will she not reject these counsels of indifference and isolation, and interest herself in what may be decisive issues for the progress and civilization of all mankind?

Was the turn in 1944 to a different post-war policy to that of 1919 a consequence of new power politics, or a new intellectual direction that overcame American isolationism? Was the key to success American power, or was it Keynes's powerful intellect that brilliantly confined and circumscribed the possibilities of applying American power?

Bretton Woods was obviously a unique occasion, whose magic was produced in part by the felicitous timing: just after the Normandy landings, when the prospect of a very speedy end to the European conflict appeared much greater than in reality it proved to be. Treasury Secretary Henry Morgenthau told a strategy meeting preparing for Bretton Woods quite candidly that: 'we felt that it was good for the world, good for the nation, and good for the Democratic Party, for us to move' (Blum, 1967, p. 248). Why was what was good for the Democratic Party really what was good for America or the world?

Was this naked power masked as idealism? At the inaugural session of the conference, Morgenthau had propounded a vision:

> I hope that this Conference will focus its attention upon two elementary economic axioms. The first of these is this: that prosperity has no fixed limits. It is not a finite substance to be diminished by division. On the contrary, the more of it that other nations enjoy, the more each nation will have for itself. . . .
> The second axiom is a corollary of the first. Prosperity, like peace, is indivisible. We cannot afford to have it scattered here or there among the fortunate or to enjoy it at the expense of others. Poverty, wherever it exists, is menacing to us all and undermines the well-being of each of us. It can no more be localized than war, but spreads and saps the economic strength of all the more-favored areas of the earth.

Along with the idealism, there were three specific lessons, in all of which idealism was tempered by a precise calculation of the balance of national interest: in trade relations,

[3] Cited in Skidelsky (1992, p. 482).

in internationalizing the New Deal, and in addressing the question of capital mobility. The American negotiators themselves were quite aware of their negotiating advantage, and knew that they should use it. As Morgenthau told Assistant Secretary Harry Dexter White, the principal negotiator of the Bretton Woods settlement, 'Now the advantage is ours here, and I personally think we should take it.' White replied: 'If the advantage were theirs, they would take it' (van Dormael, 1978, p. 211).

These lessons were substantively lost in a retrospective context.

II. The trade lesson

The Bretton Woods conference represented both an attempt to learn the lessons of the Great Depression (in the mind of the Democratic Party, i.e. of the New Deal), and a part of the preparation for peace and the post-war order. The conference was preceded by negotiations involving initially the United States and the United Kingdom, and then the other members of the United Nations (the wartime coalition against the Axis powers). The fundamental insight that made it possible to agree on an outcome was that destructive disputes over trade could be overcome by an agreement on monetary matters.

In this it broke through the paralysis that had afflicted inter-war attempts at international cooperation. The World Monetary and Economic Conference held in London 1933 was generally seen as the last, and lost, opportunity to arrive at a settlement (see Clavin, 1991, pp. 489–527). It had treated the trade and monetary issues separately. Even at the preparatory stage, work on the agenda of the London conference had been divided between two sub-committees. The Monetary Sub-committee dealt with financial issues and with currency stabilization, and the Economic Sub-committee with trade. The result of this division of labour was predictable, and would have been comic if the results had not been so tragic. The monetary discussion arrived at the conclusion that a prerequisite for stabilization was the dismantling of barriers to trade: 'Freer trade was a prerequisite of a return to normal economic conditions and a return to the gold standard.' On the other hand the trade debates produced agreement that nothing could be done without an overhaul of the international financial system since 'for ten years the world has been attempting to adjust the balance of payments by lending and borrowing instead of buying and selling'.[4] This was patently a perfect recipe for a deadlock, in which trade and currency experts thought that the other side should be the one to take the first move.

The fundamental cause of the intellectual shift between 1932 and 1933 on the one hand and the wartime discussions on the other, lay in the unflinching commitment of the world's most powerful state and economy to the principle of multilateral negotiations to reduce tariff levels and eliminate as far as possible trade quotas. This was a specifically Democratic (especially southern Democratic) vision: its major champion was Secretary of State Cordell Hull. Hull had been a Congressman and then Senator for Tennessee, and was deeply influenced by the traditional interpretation of southern

[4] League of Nations archive, Geneva (United Nations), R2672, 1 xi 1932 Second Meeting of Monetary Sub-Committee; R2671, 7 xi 1932 Third Meeting of Preparatory Committee.

interests, which saw free trade as beneficial to southern cotton exporters and other farmers, and protection as the imposition of the interests of the manufacturing states of the north-east and the mid-west. In the 1930s, as Secretary of State, he had used bilateral negotiations as a way of creating reciprocal commitments to trade liberalization. His wartime diplomacy simply followed this pattern.

The principle of the obligation to introduce currency convertibility, limits on discriminatory trading practices, and increased access to each other's markets had been inserted into Anglo–American relations as Article VII of the Lend–Lease agreement, which was generally known as 'the Consideration' and was regarded by Keynes with considerable bitterness. The original draft of the State Department specified that the two countries would commit themselves to:

> promote mutually advantageous economic relations between them and the betterment of world-wide economic relations; they shall provide against discrimination in either the United States of America or the United Kingdom against the importation of any product originating in the other country.

The measure appeared in Washington as a sledgehammer to break the carapace of British Imperial Preference. The same language was used in Clause Four of the Atlantic Charter, drawn up in shipboard meetings on the ocean at the first visit of Winston Churchill to Roosevelt. The governments committed themselves 'to further the enjoyment by all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world'.

Hull's strategy for limiting protectionist impulses rested on two pillars. First, following what had become a standard political science interpretation of the origins of the Smoot–Hawley tariff and the disasters of depression-era trade policy, there was a need to limit congressional or parliamentary politics. The political scientist Elmer Schattschneider had shown how the tariff had changed its nature in the course of congressional debate, as individual parliamentarians added on measures to protect particular interests associated with their locality. The logic of this argument is analogous to the collective action mechanism suggested by Mancur Olson: an accumulation of small interests will lead to a sub-optimal outcome, as each small interest will see major gains in a protectionist measure, and the collectivity is happy to accept this, as the overall cost of each measure is relatively trivial. Olson's suggestion is that only an over-arching articulation of a general interest can solve the collective action problem: in terms of concrete politics, this meant the strengthening of the executive and the presidency at the expense of the legislature. This was exactly the course Hull followed, with legislation (the Reciprocal Trade Agreements Act of 1934) that allowed the president to conclude bilateral trade treaties.[5]

The second logic behind Hull's strategy lay in the perception that it is safer to anchor liberal arrangements in a legal or constitutional form, and in this way also remove them from party and parliamentary politics. Anchoring the open economy in international treaties would be a way of tying political hands, or—in today's political science terminology—embedding the liberal international order.[6] In this way, an international

[5] Schattschneider (1935); Olson (1971).

[6] Ruggie (1996); Ikenberry (2001).

order might create permanent constitutional guarantees for preferences of the United States as a collectivity (but not necessarily of individual Americans or individual parliamentarians).

The uncompromising attitude of the United States brought the inescapable conclusion even to opponents and sceptics (such as Keynes) that trade liberalization could not be the subject of discussion or bargaining. The British may have suspected that the US intention was to impose free trade on other countries so that there would be ready markets for the powerful manufacturing machine, but that Congress would still maintain some domestic protection. So Keynes was eager to move ahead at the time of Bretton Woods with some kind of mechanism in the form of an International Trade Organization to ensure that the United States too was constrained. How fortunate for the world that there were no trade negotiations! When after the conclusion of the war, countries started haggling about the exemptions they desired from a proposed International Trade Organization, the United States Congress indeed revolted, and the proposed institution collapsed. Bretton Woods in this sense had already succeeded before the delegates even met because of the already established wartime consensus that trade should not be debated, and thus that an initial conference should deal with currency stabilization. The order was already embedded in pre-existing diplomacy.

III. The New Deal context

The second component was born out of the character of the conflict. Keynes was asked by the British government to prepare a counter-scheme to the German Economics Minister Walther Funk's remarkable (but insincere) plan for European prosperity of 1940. He rejected very decisively the idea that a return to 1920s internationalism might be attractive as a pattern for post-war relations. In his proposals, Keynes spoke of 'the craving for social and personal security' after the war. [7] But there were as yet few details on how an international economy might be managed to promote such security.

Very different types of economy needed to be integrated in the common vision: ones that relied (as would the UK and the US) on Keynesian macroeconomic demand management; as well as economies with central planning, including of external trade, on the Soviet model. The Soviet delegation was a part of Bretton Woods, and some of the obscurer wording of the Agreement is the result of the need to take into account Soviet peculiarities.

How could domestic priorities be reconciled with peace and broad international objectives? There were three alternative possibilities.

1. States might come to see their self-interest as lying in international harmony. The experience of the 1930s, however, did not seem encouraging.
2. An international juridical framework might be established for economic issues to arbitrate in cases where national and international objectives clashed.
3. An entirely automatic mechanism might point states in the direction of peace and prosperity without a complex and lengthy bureaucratic or juridical process.

[7] Van Dormael (1978, pp. 6–7); Gold (1984, p. 19); Moggridge (1992, p. 654).

Discussions of the post-war order swung between acceptance of the second and third of these choices, and ended by taking elements of both. Automatism was attractive because it was apolitical; but it might not always fit in with widely perceived needs. An element of discretion was needed, which might best be provided through the creation of an institution with legal powers established by treaty. The resulting compromise is the foundation of the Bretton Woods achievement.

Keynes's scheme proposed an international bank, which he called the Clearing Union, with a new unit of account that would be the basis for the issue of a new international currency. The proposed currency's name, *bancor*, indicates the way in which the new money was conceived as an artificially created replacement for gold, which should gradually be expelled from the civilized conduct of international economics. Gold might be sold by central banks to the new international bank for bancor, but would not be bought.

The object of the Union's activities would be to avoid balance-of-payments imbalances through the creation of a body of rules and practices relating to the overdrafts on the bank accumulated by debtors and the positive balances acquired by creditors. The quotas for each country in the Union were to be fixed as half of the average of imports and exports over the past 5 years. These quotas determined the limits up to which debtors could borrow (at interest rates that rose with the quantity of their debts). Creditors had to transfer to the Union surpluses above their quota, and pay charges to the Union if their balances rose above a quarter of their quota. The Keynes scheme created a nearly perfect symmetry: it was to be as unpleasant and as costly to hold credit balances as to be a debtor. The result would be the impossibility of policies such as those followed by the United States and France in the later 1920s: the rules of the Clearing Union would drive such creditor states to expand.[8]

In subsequent drafts of his proposal, Keynes wrestled with 'the most difficult question', 'to determine . . . how much to decide by rule and how much to leave to discretion' (Horsefield, 1969, p. 6). An abstract and impersonal operation would give the most scope for the operation of markets, and also for the preservation of national sovereignty. The most extreme version of a rule-bound system, however, the gold standard, had led to deflation and depression. Successive British drafts, tossed forwards and backwards between Keynes and the British Treasury and the Bank of England, gradually increased the discretionary element in what had originally been a neat and simple automatic principle of operation. Monetary authorities preferred (often they still do) 'to operate by vague requests backed by vague sanctions, rather than by publishing definite rules' (Brittan, 1988, p. 87). By the fourth draft, the balance had shifted towards discretion. The Governing Board of the International Bank might set conditions under which countries would be allowed to increase their debit balances, including the surrender of their gold reserve, the control of capital transactions, and a devaluation of the currency. But even with the introduction of consultations about policy in the place of

[8] There is a possibility that Keynes envisaged a world in which there would be more exchange-rate alterations as the major adjustment mechanism for the international monetary system, with deficit countries depreciating and surplus countries appreciating (see Vines, 2003). The practice of the Bretton Woods system was remarkably different, however, with only two (contentious) appreciations of surplus currencies in 1961 and 1969, and it would have been difficult in 1944–5 to envisage the circumstances in which the United States, where the surpluses were likely to be for the foreseeable future, agreed to an appreciation of the dollar.

rules of conduct, there still existed a symmetry between the constraints on debtors and creditors. If a credit balance exceeded half the quota, the country would be required to 'discuss with the Governing Board (but still retain the ultimate decision in its own hands)' an expansion of domestic credit and demand, an exchange-rate revaluation, an increase in wages, tariff reductions, or international loans for the development of backward countries. The US gradually intervened in the negotiations to avoid being forced into expansionary policies simply by virtue of its debtor position. This was possible, because international capital movements would largely be controlled.

IV. The intellectual context

Keynes did not believe in what might be called the 'globalization paradigm': the theory, elaborated already by Montesquieu and celebrated by Richard Cobden and John Bright as well as by Normal Angell, that commerce and commercial inter-connectedness would by themselves bring international peace and order. In the *Economic Consequences of the Peace* (Keynes, 1919, pp. 263–4) he had written:

> Bankers are used to this system, and believe it to be a necessary part of the permanent order of society. They are disposed to believe, therefore, by analogy with it, that a comparable system between Governments, on a far vaster and definitely oppressive scale, represented by no real assets, and less closely associated with the property system, is natural and reasonable and in conformity with human nature. I doubt this view of the world. Even capitalism at home, which engages many local sympathies, which plays a real part in the daily process of production, and upon the security of which the present organisation of society largely depends, is not very safe.

The Bretton Woods scheme depended on a worldwide agreement on the control of capital movements, which was presented as a 'permanent feature' of the post-war system (Horsefield, 1969, p. 13). The Union would work closely not only with an agency dedicated to stabilizing prices (in order 'to control the Trade Cycle'), but also with a super-national peace-keeping agency ('charged with the duty of preserving the peace and maintaining international order'). The British draft concluded that the proposal was 'capable of arousing enthusiasm because it makes a beginning at the future economic ordering of the world between nations and the "winning of the peace", and might help to create the conditions and the atmosphere in which much else would be made easier'.

A new consensus on the causes of the Great Depression had shifted the emphasis away from the favourite villains of the 1930s literature—the uneven distribution of gold and the sterilizing policies of the Banque de France and the Federal Reserve System, or the allegedly excessive monetary inflation of the 1920s, or structural weaknesses in major industrial centres. Rather the new view looked at the transmission process of depression, and came to the conclusion that the large short-term capital flows of the 1920s and 1930s had led to disaster. These movements had made it impossible for states to pursue stable monetary policies, they threatened exchange-rate stability, and they made fiscal stabilization highly hazardous.

This approach to the inter-war economy oriented towards the diagnosis of capital movements as the fundamental ill had been developed by League of Nations economists in the 1930s. The most influential academic statement was Ragnar Nurkse's *International Currency Experience* (1944): 'In the absence of international reserves large enough to meet such speculative and often self-perpetuating capital movements, many countries had to resort to exchange control and to other less insidious means of correcting the balance of payments.' From this historical experience, Nurkse drew the conclusion that greater international cooperation was needed: 'But if, owing to anticipated exchange adjustments, political unrest or similar causes, closer control of hot money movements is inevitable, then some of its difficulties and dangers might be overcome by international understanding.' As a consequence, when he wrote about plans for an international bank or monetary fund, Nurkse added:

> If, in addition to trade and other normal transactions, such a fund had to cover all kinds of capital flight, it might have to be endowed with enormous resources. In fact, no fund of any practicable size might be sufficient to offset mass movements of nervous flight capital.[9]

The restoration of a multilateral financial system thus depended in the view of almost every analyst on control of capital movements for an unlimited time. This approach appealed to Keynes, who had repeatedly asserted his scepticism about the benefits of both capital exports and capital imports. Keynes fully shared the belief that capital flight had been the major international inter-war problem:

> There is no country which can, in future, safely allow the flight of funds for political reasons or to evade domestic taxation or in anticipation of the owner turning refugee. Equally, there is no country that can safely receive fugitive funds, which constitute an unwanted import of capital, yet cannot safely be used for fixed investment.[10]

It is true that Keynes added that the new controls, which might become a 'permanent feature of the post-war system', should not bring an end to the 'era of international investment': but it would need states and international agreements to define (in accordance with national priorities) what was desirable investment and what was unwanted capital movement. The British economist Sir Hubert Henderson noted: 'It has been generally agreed in the United Kingdom that we must retain the right to regulate capital movements, effectively and indefinitely'.[11] Many Americans also shared this view.

In the United States, the feeling that the capital exports of the 1920s had been misused was a commonplace for the New Deal. Harry Dexter White, Assistant to the US Treasury Secretary, and the other major architect of what would be the Bretton Woods agreements, fully concurred with Keynes that: 'The theoretical bases for the belief still so widely held, that interference with trade and with capital and gold movements etc., are harmful, are hangovers from a Nineteenth Century economic creed, which held that international economic adjustments, if left alone, would work themselves out toward an

9 Nurkse (1944, pp. 220, 222, 188).
10 Horsefield (1969, p. 31); see also Moggridge (1992, p. 673).
11 Bank of England archive OV38/49, Sir Hubert Henderson note of 1 August 1944.

`equilibrium' with a minimum of harm to world trade and prosperity. . . The task before us is not to prohibit instruments of control but to develop those measures of control, those policies of administering such control, as will be the most effective in obtaining the objectives of world-wide sustained prosperity' (Horsefield, 1969, p. 64). White's immediate superior, Treasury Secretary Henry Morgenthau, made the target of these controls much more explicit. The new institutions of the international order would be 'instrumentalities of sovereign governments and not of private financial interests'. The task that the statesmen should set themselves was to 'drive the usurious moneylenders from the temple of international finance' (Gardner, 1969, p. 76). But this was primarily a political task.

Producing an agreement was possible because of the wide extent of agreement in the initial bargaining positions.[12] Keynes wrote of his proposals that they:

> lay no claim to originality. They are an attempt to reduce to practical shape certain general ideas belonging to the contemporary climate of economic opinion, which have been given publicity in recent months by writers of several different nationalities. It is difficult to see how any plan can be successful which does not use these general ideas, which are born of the spirit of the age.[13]

V. The retrospective context: global

It took a long time for anything like the Bretton Woods system to come into operation. The right in the United States was hostile, and American bankers lobbied against the Bretton Woods agreements, which they saw as costly concessions to foreigners and to socialist and redistributive principles. For them, there was too much of the New Deal in the scheme. In the United Kingdom, the agreements were attacked by economic nationalists both on the left of the Labour party, and on the right of the Conservative party. For these politicians, the scheme was simply too American. The attempt to impose convertibility on Britain rapidly proved to be a fiasco in July 1947. The US administration took a different path to European reconstruction with the European recovery programme (or Marshall Plan), whose administration was deliberately not entrusted to the International Monetary Fund (IMF), but rather to the Basel-based Bank of International Settlements (BIS), a relic of the interwar years of bankers' diplomacy which the New Dealers hated, and whose termination had been provided for in the Bretton Woods agreements. The European Payments Union, administered through the BIS, was a clearing mechanism restricted to Europe, and institutionalizing discrimination against the dollar.

The major European economies only restored current account convertibility, in line with the requirements of Article VIII of the IMF's articles of agreement after 1958, and Japan in 1964. By 1968 the par-value system was in obvious crisis, and between 1971 and 1973 it broke down. Despite the fact that it only 'worked' for a few years, it

[12] A modern commentator speaks of the existence of a 'primitive epistemic community' of expert economic opinion-makers: Ikenberry (1992, p. 293).

[13] Horsefield (1969, p. 21).

is held to constitute a success. Something like a modified capitalist order was indeed re-established.

Interests and ideas had overlapped in creating the post-war monetary order. It is striking that, in retrospect, Bretton Woods appears as the only really successful example of a multilateral redesign of the world's international monetary order: Napoleon III had tried to establish a world money at the World Monetary Conference of 1867; the Genoa conference in 1922 was ineffective in proposing a blueprint for monetary stability after the First World War; in 1971 Richard Nixon termed the Smithsonian meeting the most important monetary conference since the birth of Jesus Christ, but the new exchange rates held for less than 2 years; and ever since the disintegration of the Bretton Woods regime in the early 1970s, economists and policy-makers have been calling in vain for a new Bretton Woods. Such reforms never materialized because of monetary multilateralism: there is no single power or like-minded group of powers that can impose their plan on a complicated and perhaps uncontrollable market of ideas and interests.

Bilateral talks subsequently remained the key to every major success of large-scale financial diplomacy. In the early 1970s, when the fixed exchange-rate regime came to an end, the IMF seemed to have outlived its function. Its Articles of Agreement were renegotiated by the US, which was looking for more flexibility, and France, which wanted something of the solidity and predictability of the old gold standard.

Later in the 1970s, European monetary relations were hopeless when France, Germany, and Britain tried to talk about them, but were straightened out when only France and Germany took part. In the mid-1980s, when wild exchange-rate swings produced calls for new trade protection measures, the US and Japan found a solution that involved exchange-rate stabilization. Today the major focus of international economic diplomacy is again bilateral, between the US and China.

In recent years, a debate has developed about whether the world of the 2000s constructed a 'Bretton Woods II', in which rapidly growing export-led economies peg to the dollar (more or less) in order to obtain faster growth, and consequently accumulate reserves at spectacular rates. The issues raised in a series of articles by Dooley, Folkerts-Landau, and Garber concern the sustainability of the current monetary system (or non-system) and of the 'global imbalances' (Dooley *et al.*, 2003, 2004*a*,*b*,*c*). But they also raise the questions about how sustainable the original Bretton Woods order really was; and obviously also about how appropriate the analogy of the 1960s and the 2000s can be, and what it was about this analogy that originated in a wartime conference.

The prevailing view is that the 1960s collapse of Bretton Woods was inevitable, and was only staved off by quite able and sophisticated management of the system through the 1960s, in particular through the action of the BIS and the creation of the swap system, and through the GAB (General Arrangements to Borrow). Two views are usually presented to explain the ineluctability of breakdown: the first, following the analysis given by Robert Triffin, in which the growth of other countries' dollar reserves (or claims on the US) would lead to an increasing probability of crises of confidence, as reserve holders might realize that their assets were not liquid in the sense that they might not be convertible into gold. Alternatively, if reserve accumulation did not occur, the world would face liquidity shortages (Triffin, 1960). For part of the 1960s, more attention focused on the latter part of the dilemma, and the construction of the Special Drawing Right (SDR) was intended to relieve liquidity constraints. It was thus ironical that by the time that the SDR came to be issued, the world was perhaps suffering more from the first arm of the dilemma, namely that of excessive reserve creation leading to crises of confidence. The dollar appeared to be like the infamous Chevrolet Corsair, which the burgeoning consumer movement in the US had condemned as being 'unsafe at any speed': threatening world deflation if too slow, or inflation and crises of confidence if too fast.

The second interpretation sees the problem in terms of the inconsistent trinity, that became well known from debates about whether a new version of Bretton Woods could be applied in the regional setting of the European Monetary System after 1979 (Padoa-Schioppa, 1988). Fixed exchange rates, capital mobility, and independent monetary policies are inconsistent with each other. The presence of capital mobility in a fixed-rate regime makes it impossible for countries to set their own monetary policies or determine their own monetary preferences. As applied to Bretton Woods, this interpretation emphasizes the frustration of some of the growing export economies about rising levels of inflation that were interpreted as being imported from the United States.

Neither of these widely shared interpretations is completely watertight, either factually or logically. The problems of the 1960s look much more easily soluble in retrospect, when compared with the challenges posed by global imbalances in the new millennium.

In particular, if the world (that is the world outside the US) needed reserves, why should it worry that they might not be completely converted into gold at an instant's notice? The build-up of reserves looks more analogous to the accumulation of assets in a bank, where individual countries (depositors) might suddenly need to call on their assets, and could have a legitimate expectation of being able to do this. But there is also recognition that all countries (depositors) cannot convert their assets at the same time, without bringing down the bank. This analogy, made by Kindleberger, Despres, and Salant at the time (Despres *et al.*, 1966, pp. 526–9), was a minority view, but it is quite a convincing point (unless one assumes a widespread fixation with gold in an age in which actual metallic money, circulating through individuals' pockets, was a more and more dated historical memory).

The world had moved to current account convertibility in the late 1950s and early 1960s, but there was no generalized liberalization of capital accounts. The inconsistent trinity is properly applied as a problem of the European Monetary System's exchange-rate mechanism in the 1980s and early 1990s, and the strains that resulted did produce the major crises of 1992 and 1993. But it is not a good description of the issues of the 1960s, in which the behaviour of the large and dynamic export economies, especially Japan and West Germany, bear a closer analogy to Chinese management of its currency up to 2005. The US tried to restrict movements with its increased taxation of foreign earnings of US corporations and with the 1963 Interest Equalization Tax, although it became clear that such measures were ineffective and also in part counterproductive as they reduced the return flow of income from American investments.[14] But the other industrial countries, with the exception of Switzerland, had much more restrictive regimes and controls on the movement of capital. Nevertheless, some capital movements occurred, because trade invoicing can be used to move capital, particularly if there is an expectation of exchange-rate changes. There was also a substantial pool of

[14] Meltzer (1991, pp. 54–83); also Bordo (1993).

offshore dollars, unconstrained by US capital controls, as the Euro-markets developed. Capital inflows to Germany from January 1970 to May 1971 (when one of the two principal export surplus countries floated, without destroying the system) amounted to DM35.3 billion ($9.6 billion). These were flows in expectation of a renewed German revaluation. In 1971, Japan, the other big surplus country, had an inflow of $4.91 billion) While these were seen as very substantial flows by the standards of the time, they are modest by comparison with the extent of capital movements in settings in which there are no capital controls (i.e. the world of the 1990s and beyond). The inflow to Germany amounted to 6.6 per cent of GDP, and to Japan to 2.2 per cent. If we look at increases in total reserves (foreign exchange, IMF position, and gold), the increases for Germany amounted to 3.6 per cent of GDP in 1970 and 2.2 per cent in 1971; for Japan to 0.4 per cent in 1969, 0.6 per cent in 1970, and 4.1 per cent in 1971. It is difficult to envisage a modern-style private-sector speculative attack on the United States: the more likely (and the more feared) outcome was one in which official (rather than private) conversions would provoke a crisis. The triggering event in August 1971 which led to the US decision to close the gold window was a fear that Britain (and other sterling area countries) would convert dollar reserves.

The Bretton Woods order of the 1960s thus looks eminently sustainable in theory, and more sustainable than it was in practice: especially when the movements of the 1960s are compared with the extent of modern behaviour of foreign-exchange markets in a world with much higher capital mobility. Daily world foreign-exchange transactions in 2007 amounted to $3,210 billion (BIS). Chinese reserves in the 2000s have increased at an annualized rate of $250 billion (with signs of the rate increasing), in other words of an annual amount equivalent to 10 per cent of GDP.

There is also no doubt that by most criteria the Bretton Woods order was stable and beneficent. As Michael Bordo put it in his comprehensive survey (Bordo, 1993, p. 27): 'The Bretton Woods regime exhibited the best overall macro performance of any regime. . . . This is especially so for the convertible period 1959–70 . . . both nominal and real variable were the most stable in this period.'

So what is the real story of the collapse of Bretton Woods? There is no doubt that exchange rates had become inflexible, because of the worry that the possibility of movements would set off speculative movements. The adjustable peg system created the potential for one-way bets that could force countries into crisis measure adjustment. Unwillingness to adjust on the part of countries pegged to the dollar (the United States being the one country which could not change its exchange rate) increased the sense that the dollar's role was problematical.

The heart of the story lies in the political economy of the reaction in the United States to the surge of exports from the 'emergers' of the time, in particular from Japan. This was the theme that John Connolly took up again and again, notably in his May 1971 Munich speech at the International Banking Conference. It became a part of congressional politics with the 6 August 1971 report of the Joint Economic Committee's Sub-committee on International Exchange and Payments which presented the 'inescapable conclusion' that the 'dollar is overvalued'. Exchange rates were to be used as a weapon to secure market opening in Japan and Europe at a time when the question of Japanese textile exports to the US was producing major congressional pressure for immediate action, and was likely to be a central issue in the 1972 election. The dollar crisis, and the associated temporary import surcharge, was used by an administration that was not particularly engaged in multilateral international financial diplomacy, in order to deal with a pressing issue in domestic politics.

Exchange-rate changes do not simply and directly affect trade performance and competitiveness in the way that simple textbook models or their political interpreters think. In particular, a literature has developed to show why exchange-rate devaluations for big industrial countries do not immediately improve the trade balance (McKinnon, 2009). And indeed the formal reduction of the dollar parity at the Smithsonian G-10 meeting in December 1971 did nothing to reduce the US merchandise deficit, which rose from \$2.27 billion in 1971 to \$6.42 billion in 1972. In terms of addressing the problem which it was supposed to resolve, the 'cure' was (like many medical cures in the pre-modern era) much worse than the malady against which it was directed.

The dollar remained the world's leading currency after 1971, contrary to almost all the doom-laden commentary after 15 August 1971 (but as predicted by Robert Mundell in a short and quite remarkable essay, originally presented at a conference in 1970, which also forecast European monetary integration and the collapse of communism—Mundell (1971)).

Immediately after the 1971 crisis, Paul Volcker, the US Treasury official responsible for managing the crisis, set out in quite subtle terms what seemed a very ambiguous and half-hearted defence of continuing to negotiate internationally, even though it was not clear whether there would be an outcome in the conventional sense:

> This initial effort may well have a relatively high probability of failure—but, even if it fails in its immediate objectives, it could be important in keeping open the path to 'benign regionalism.' . . . To try and fail is not to lose. It will tend, in all probability, to maintain a more constructive attitude internationally than an appearance of turning our back.[15]

Monetary negotiations could in particular help to take the political pressure off more sensitive and vulnerable elements of the world's economic framework. This justification was, as Volcker saw, an important motivation of the new European drive to have a miniature Bretton Woods, or what Volcker called 'benign regionalism'.

The principal achievement of 1971 is a negative one: by shifting political discontent directed at the trade regime (the undisputed source of the world's massive post-1945 wealth creation and, indeed, the heart of Cordell Hull's vision) on to the prominent and emotional issues around the international role of the dollar, the world escaped (though only just) a big trade war, and a reversal to the interwar era and the story of the repercussions of the Smoot–Hawley tariff. The centrality of the American dollar was the real legacy of Bretton Woods.

VI. The retrospective context: European

In Europe, policy-makers engaged for decades in a search for an alternative to a dollar-dominated world. The creation of the European Monetary System in 1979 was

[15] Quoted in James (1996, p. 235).

a self-conscious response to the rapid decline of the dollar in 1977–8, the perceived crisis in American leadership under Jimmy Carter, and the consequent search for a new mechanism internationally to replace the dollar standard. The core of the new approach was originally intended to be a basket currency as a unit of account, the European Currency Unit (or ECU, which conveniently echoed the name of an ancient French coin). A new European money would possibly be a replacement for the dollar, and thus take some of the strains out of the international monetary system. The making of a European Monetary System in 1978 was seen as a 'European contribution to solve the problem of the dollar'.[16]

There were also parallels in thinking about how an international currency could operate between attempts to redesign or reform the IMF's artificial currency (the 'Special Drawing Right') on the one hand, and ideas of making the ECU into a currency on the other. At a dinner in Marienburg Castle on 7 April 1978, German Chancellor Helmut Schmidt proposed that a European Monetary Fund be created, as a regional version of the IMF and as a revival of some of the 1940s idealism that had driven the Bretton Woods conference. Countries should pool a significant part of their reserves, they should increasingly use EC currencies rather than dollars in foreign-exchange intervention, and there should be an enhanced use of the European Unit of Account (EUA) (Ludlow, 1982, pp. 90–2). In Schmidt's view, these proposals would move the world away from reliance on the dollar as the sole reserve currency; he even held out the prospect that OPEC members might invest a part of their surplus in the EUA, and that a new European Monetary Fund might issue EUA-denominated Special Drawing Rights.

> To the extent that the EUA became an alternative reserve instrument it would take the pressure off the dollar . . . there is absolutely nothing anti-American in the scheme although it might lead to the EC becoming a little bit more inward-looking than in the past.[17]

The European Monetary System, but also its logical successor, European monetary union, were intended as answers not just to the question of the dollar but to a problem that was analogous to that confronting the world at the time of the Bretton Woods conference: in 1944, economists could reckon with a long era of US surpluses; in the 1970s and later, policy-makers were trying to grapple with the problem of German surpluses. In the 1970s, as in the 1940s, the policy-makers had to take trade openness in Europe as a given (it followed from the original conception of the European Economic Community in the 1957 Treaty of Rome); in the 1990s, in addition, they had to work with free capital flows, and in that additional context, monetary union—and the surrender of national monetary autonomy—appeared as the only policy solution.

West Germany had emerged by the 1960s as the strongest European economy, with a dynamism driven by a powerful export performance. German current account surpluses, driven primarily by trade surpluses, which appeared briefly in the 1950s, were corrected after a currency revaluation in 1961, but then emerged again in surges in the late 1960s, the late 1970s, a more powerful burst in the late 1980s as capital movements were liberalized, and again in the 2000s. They disappeared in the 1990s, when

[16] Bundesbank archive (HADB) N2/264, Karl Otto Pöhl to Helmut Schmidt, 21 March 1978.
[17] British National Archives, PREM 16/1615, Schmidt note on remarks at Copenhagen summit.

the costs of German unification pushed the German external account into deficit, and Germany's relations with its European partners were consequently more harmonious. The counterpart of the current account surplus was a high level of savings that was in part channelled abroad to finance deficits that appeared elsewhere.

The German surpluses provided a focus of attention both on a global and a European scale. Could the imbalances be financed and sustained? If not, there was a need for adjustment. At each stage, the extent of the imbalance measured as a share of GDP increased, mostly because international capital markets were deeper and thus allowed bigger imbalances to be financed for longer periods. One way of thinking about these imbalances is as a reflection of changes in relative competitiveness. Thus a German surplus was a reflection of a favourable development of productivity gains, and of wage costs contained by a collaborative and collective approach to wage-setting that came to be the hallmark of late twentieth century German-style capitalism. By contrast, deficits in Germany's trade partners reflected either lower innovation or (especially in late 1960s France and Italy) a less disciplined approach to wages in an era of full employment and increased social radicalism.

At the beginning, in the Bretton Woods era of fixed exchange rates and controlled capital markets, even relatively small deficits could not be financed, and produced immediate pressure on the exchange markets. The deficit countries then had to apply fiscal brakes in a stop–go cycle. Germany's partners, and notably France, were faced by the prospect of austerity and deflation in order to correct deficits. This alternative was unattractive to the French political élite, because it constrained growth and guaranteed electoral unpopularity. Their preferred policy alternative was thus German expansion, but this course was unpopular with a German public worried about the legacy of inflation, and was opposed by the powerful and independent central bank, the Deutsche Bundesbank. Solving the question of the German current accounts in the European setting at first appeared to require some sophisticated and ingenious political mechanism, that would force French politicians to impose more austerity than they would have liked, and Germans less price orthodoxy than they thought they needed. The key relationship was bilateral. A political mechanism, however, requires continual negotiation and public deliberation, and that would have been painful given the policy preferences in the two countries (and in those countries that lined up with each one of the Big Two).

The increased attraction of monetary union was that it required no such political process, and that the operation of an entirely automatic device would constrain political debate, initiative, and policy choice. The monetary union occurred in the aftermath of an era of capital market liberalization, in which current account imbalances were sustainable for much longer periods. The effects of movements in capital in allowing current account imbalances to build up to a much greater extent, and ensuring that corrections, when they occurred, would be much more dramatic, was already noticeable in the late 1980s and early 1990s, before the move to monetary union. Indeed, those large build-ups in the imbalances were what convinced Europe's policy-makers that a monetary union was the only way of avoiding the risk of periodic crises with currency realignments whose trade policy consequences threatened the survival of an integrated internal European market.

In the monetary union, Germany's surpluses simply resulted initially in private-sector capital flows. When these capital flows stopped in the wake of a sovereign debt crisis, the surpluses and deficits still persisted: there was no immediate and automatic adjustment. Instead, the imbalances were financed through the new central banking system, absolutely automatically through the TARGET2 payments mechanism. Keynes's synthetic international currency, *bancor,* was intended to guarantee stability and the avoidance of deflation, on a global level (Skidelsky, 2000, p. 221). As an outcome of no explicit planning for such an eventuality, Keynes's vision of automatic and non-discretionary financing of imbalances has been most perfectly realized in the context of the European Monetary Union.

That functioning is, however, deeply controversial. The German economists who called attention to the manner and consequences of TARGET2 operations worried about the implicit liability of the creditor central banks in the event of a default.[18] The working of monetary union proved to be easily as controversial as Keynes's proposal of 1944.

VII. General reflections

In the earlier age of worries about globalization at the turn of the nineteenth century, a backlash began, which in the end produced restrictions on migration and high levels of trade protection. When national protection became the major priority of most countries, in the 1920s and 1930s, the world became both poorer and less safe. There was a vicious cycle, in which external forces were blamed for loss and disaster, and high levels of trade protection destroyed national prosperity.

Most countries have avoided this sort of backlash in the second half of the twentieth century, although their citizens had the same angst. There are obvious parallels between British concerns about German competition with cheap labour and the power of the new German industries in the 1880s and 1890s and the worries of Americans about the Japanese threat in the 1960s and that of China today. The changing of employment patterns is a constant accompaniment of growth. In the early 1970s and again in the 1980s US workers and producers were upset about the loss of jobs to Japan. Some of the most skilled jobs, in automobiles, were lost; household appliances such as TVs were no longer made in the United States. On each occasion, the administration tried to respond to the job-loss worries not by trade restrictions, but by exchange-rate alterations that would make the US products more competitive: first, the end of the gold convertibility of the dollar in 1971, and then, in 1985, the Plaza agreement to depreciate the dollar. Monetary and exchange-rate policy initiatives offered a way of absorbing adjustment pain. The focus of trade discontent was shifted to the monetary arena in a way that helped to undermine the legitimacy of institutional ways of regulating the international financial system.

The use of monetary policy and exchange-rate adjustment to de-escalate trade conflict is harder today, since many of the countries whose products are entering the United States peg their own currencies in more or less formal ways to the dollar. Governments still feel that they need some response in an attempt to 'feel the pain', and to show

[18] See Sinn and Wollmershäuser (2011).

that they are doing something. Like the Bush administration they adopt tariffs that may then be over-ruled by the World Trade Organization. In this way they do nothing very harmful, but point out to the electorate that their hands are tied by international agreements and institutions. But this sort of action itself then produces a new kind of backlash, against the international institutions.

Trade problems are, in fact, routinely dealt with by shifting the emphasis to the monetary arena. The world has developed its institutional arrangements in the setting of globalization away from the Bretton Woods settlement by making them harder in the trade arena and softer in the monetary one.

In the future the offloading of adjustment problems to monetary policy (that was the most useful part of the 1971 exercise) will be more difficult because of widespread Asian exchange-rate pegging and because of the new informal and largely privatized character of the international monetary system. Something of this reverse reaction is evident in the Schumer–Graham amendment passed by the US Senate in 2005, which provided for a 27.5 per cent tariff on all Chinese goods entering the United States unless China revalued its currency. Monetary issues now produce trade responses, and threaten the basic element of the Bretton Woods formula.

In the same way as the Versailles Treaty produced a negative mythology, in which all the bad and unstable elements of interwar politics were attributed to the peace treaty rather than to the destruction of the war, Bretton Woods took on a positive mythology. According to that version, an act of enlightened creative internationalism removed obstacles to aligning the interests of multiple nation states and of economic agents, and providing a new synthesis of state and market. Bretton Woods was the intellectual sugar, covering and masking the bitter taste of the pill of *Realpolitik* dollar hegemony. But it also provided a sugar coating for the unpleasant taste of internationalism in the domestic context of American politics.

In the post-1970s debate, which is still continuing today, two issues were conflated: the question of why there has not been another Bretton Woods; and the perception that the world economy is in a mess, and that an international market order (or capitalism) has not been properly restored. The conflation leads to the constant demand for another Bretton Woods, and, indeed, for another Keynes, or another US in its 1944 embodiment as a power standing for liberal international principles. In other words, it continually regenerates the myth of Bretton Woods, or of how benign multilateralism once rescued the world.

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