# Reflections on Bretton Woods

**Edward M. Bernstein***

To those who had experience with the difficulty of getting international cooperation after World War I, the Bretton Woods Conference seemed like a miracle. The half dozen or more conferences on economic, monetary, and reparations problems from 1920 to 1933 accomplished nothing except the establishment of the Bank for International Settlements to deal with the transfer of reparations. The economic section of the League of Nations had a committee of experts that studied the gold question for several years, but their report came after Britain abandoned the gold standard and, in any case, was not unanimous. By contrast, the Bretton Woods Conference was very successful. One reason was the thorough technical preparation which began two and a half years before the Conference was held. Another reason was that the failure to agree on a plan would have had a serious effect on morale in the allied countries.

This does not mean that there was general agreement on what the postwar problems would be. One widely held view was that the greatest problem was the danger of a recurrence of a deep depression in the United States. Those who held this view wanted the resources of the new institution to be very large, to expand steadily, and to be available automatically. They also wanted considerable freedom for countries to change exchange rates, to maintain exchange restrictions, and to postpone convertibility. At the time Keynes wrote his proposal for a Clearing Union, he probably leaned to this pessimistic view of the postwar world. At a dinner he gave to Walter Gardner and me in 1943, Keynes said that the United States would be glad that the new institution would allow control of capital flows, as there could be a flight from the dollar after the war. I asked whether that was because there might be a depression in the United States and a fear of a possible devaluation of the dollar. Keynes said that was what he meant. After Bretton Woods, however, Keynes came to believe that the dollar payments problem would be solved by expansion in the United States.

Harry White thought that the most important postwar problem was the threat of competitive exchange depreciation and discriminatory exchange controls. He thought that Britain would quickly recover its capacity to produce and that the $4 billion of sterling balances accumulated during the war would give her an unfair advantage in exporting to the countries that held these balances. White also feared that Britain might devalue sterling immediately after the war and thus add to its competitive advantage in world export markets. After the Bretton Woods Conference he testified before the Senate Banking Committee that if the International Monetary Fund were established, Britain would need no help from the United States after the war.

*Guest Scholar, The Brookings Institution.

When I wrote the report of the Senate Banking Committee on Bretton Woods, I said plainly that the Committee did not agree with White's testimony and that Britain's need for a loan would have to be determined in the light of conditions at the end of the war.

Even within the U.S. technical group there were differences of opinion regarding the White Plan for an International Stabilization Fund. At that time, many economists in this country held the view that the U.S. economy was doomed to stagnation, and they preferred a bolder plan. Even Professor Jacob Viner thought that the White Plan was too cautious. He described it as providing an umbrella when the world needed a bomb shelter.

On the other hand, the Federal Reserve Board believed that the White Plan did not impose enough discipline. My notes on the meeting that White and I had with the Federal Reserve Governors and the staff contain this statement: "Mr. Gardner raised the question whether it wouldn't be desirable to require so much gold to be paid into the Fund that no country would have sufficient free gold to be able to disturb the international balance of payments without being subject to the discipline of the Fund." White and I also met with the directors and officers of the Federal Reserve Bank of New York where John Williams expressed the view that the structure of the White Plan was too elaborate. He thought the practical approach would be an agreement with Britain to stabilize the dollar/sterling exchange rate—the two key currencies. He later changed this, perhaps in response to our criticism, to the key-country approach.

Both the United States and the United Kingdom discussed their plans with other countries. My notes show that we held discussions with 28 countries, some brief and some extended. The longest discussions, as would be expected, were with the British and covered both the White Plan and the Keynes Plan. The Canadians produced some proposals of their own to bridge the differences in the U.S. and British plans, with some new ideas not in either plan. The Treasury amended the White Plan on the basis of these discussions to take account of the main concerns of other countries. Although we did not believe there would be a postwar depression or that the U.S. balance of payments would cause difficulties for other countries, we agreed to include a scarce currency provision in the White Plan. This would allow other countries to impose discriminatory restrictions against the United States if the dollar holdings of the Fund became scarce because of a large and persistent U.S. surplus as a result of a depression in the United States. By these compromises we reached agreement on the main features of the new institution.

The agreement was put in the form of a Joint Statement of Experts on the Establishment of an International Monetary Fund. It covered the purposes and policies of the Fund, par values and changes in exchange rates, scarce currencies, and the transitional arrangements on exchange controls. These were the principles for which the Bretton Woods Conference would provide the details. A wide range of detail can be said to embody the same principle, so that there was plenty of work to be done at Bretton Woods. The Conference had two commissions, one on the Fund over which White presided, and the other on the Bank over which Keynes presided. The Fund

Commission had four committees which considered the relevant parts of the Joint Statement and alternative provisions that the participants submitted.

The work went surprisingly well. The U.S. delegates, the chief technical adviser and the chief legal adviser met every morning to discuss the questions that came up and to instruct our representatives on the committees as to the U.S. position. There were a few questions that the Fund Commission could not resolve and they were finally referred to a Special Committee on Unsettled Problems. The greatest credit for resolving all problems, however, should go to the drafting committee which found the right words to reconcile lingering differences. At a dinner in Ottawa last year, I heard Governor Rasminsky, who was chairman of the drafting committee, explain that there were no unintentional ambiguities in the Fund Agreement.

It says much for the skill and tact of the drafting committee that there was universal satisfaction with the Articles of Agreement. Even Keynes, who had fought hard in the discussions with the United States to have the new institution in the form of the Clearing Union, stated later in the House of Lords that "the new plan... [is] in some respects... a considerable improvement on either of its parents." I am glad to second that view. The Fund Agreement that came out of Bretton Woods was simpler, clearer, and more workable than either the Keynes Plan or the White Plan.

I have sometimes wondered whether Keynes really wanted everything that he argued for in the Clearing Union. At a meeting in the Treasury in October 1943, Keynes announced that Britain was willing to accept the amended White Plan, but that he wanted to rewrite it in terms of the bancor. If the British were willing to accept the White Plan, I asked, what was the need to rewrite it. Because, Keynes said with vehemence, your plan is written in Cherokee. Later, in a speech in the House of Lords, Keynes said that with the new agreement "there is no longer any need for a new-fangled international monetary unit. Your Lordships will remember how little any of us liked the names proposed—bancor, unitas, dolphin, bezant, daric and heaven knows what." I think Keynes would have liked SDRs but not the name.

I am not sure that Keynes really wanted as large a fund as in the Clearing Union proposal—about $30 billion initially and about $2,500 billion now. Even the initial sum was too large to let countries have unconditional access to such quotas. In the Clearing Union proposal, Keynes said that "there should be the least possible interference with internal national policies... [but] since such policies may have important repercussions in international relations they cannot be left out of account." His conclusion was that the proposed institution "should be limited to recommendations, or at most, to imposing conditions for more extended enjoyment of the facilities which the institution offers." And in a letter to me after the Conference, Keynes wrote: "I should like to see the Board of the Fund composed of cautious bankers, and the Board of the Bank of imaginative expansionists." Of course, Keynes was talking about the bankers of 1945, not those of 1983.

What was unique about the International Monetary Fund? The provision of reserve credit to central banks was not a novelty. The Bank of England had borrowed gold or dollars on several occasions in the past when its reserve position was strained. And several writers had suggested in the

1930s that the deflationary effects of gold settlements could be avoided if surplus countries acquired foreign currencies rather than gold. Even the concept that exchange rates are a matter of international concern was not new. Marshall noted it in 1887, and the 1936 Tripartite Declaration of the United States, the United Kingdom and France, to which Belgium, the Netherlands, and Switzerland adhered, gave formal recognition to this principle.

What was most novel in the Fund was the concept of a system of fixed but adjustable par values without the rigidity of the gold standard. The Fund Agreement had numerous provisions on gold, including the requirement that the par value of a currency be stated in terms of gold as a common denominator. Furthermore, to fulfill its obligation to maintain exchange stability under the Fund Agreement, the United States notified the Fund that it would buy and sell gold freely for settlement of international transactions. These provisions, however, were not enough, in my opinion, to make the Bretton Woods system a new form of the gold standard.

In his speech in the House of Lords, Keynes said that the International Monetary Fund is the very opposite of the gold standard. "The gold standard, as I understand it," he said, "means a system under which the external value of a national currency is rigidly tied to a fixed quantity of gold which can only honourably be broken under *force majeure*; and it involves a financial policy which compels the internal value of the domestic currency to conform to this external value as fixed in terms of gold... [The Fund] plan introduces in this respect an epoch-making innovation in an international institution, the object of which is to lay down sound and orthodox principles. For instead of maintaining the principle that the external value of a national currency should conform to a prescribed *de jure* external value, it provides that its external value should be altered if necessary so as to conform to whatever *de facto* internal value results from domestic policies."

In spite of the Gold Reserve Act of 1934, the United States was not really on a gold standard. The essence of the gold standard is that the money supply must be limited by the gold reserve. The last time that the Federal Reserve tightened monetary policy because the gold reserve ratio fell close to the legal minimum was in March 1933. Since then, whenever the gold reserve neared the legal minimum, the required reserve ratio was reduced and finally eliminated entirely. A country that loses more than half of its gold reserve, as the United States did in 1958–71, without reducing the money supply is not on the gold standard. What happened in August 1971 was the abandonment of the anomoly of dollar convertibility into gold when the United States was not on a gold standard.

If the Bretton Woods system was not a variant of the gold standard, how could exchange rates be kept stable? It was assumed that if the United States maintained reasonable stability of prices and costs, other countries would be impelled to follow similar policies because of the emphasis they placed on maintaining the dollar exchange rates for their currencies. They could finance cyclical changes in their balance of payments through changes in their own reserves and by drawings on and repayments to the Fund. They could add to their independent reserves without depleting U.S. gold reserves through gradual additions to their official holdings of dollars and by acquiring most of the newly mined gold that was not absorbed in the arts and industry. A trend change in a country's international payments position, however, would have to be met by a change in the par value of its currency.

The system did work more or less that way until 1957. At the end of that year, the gold reserves of the United States were the same as they had been at the end of 1950. For the rest of the world, reserves had increased by about \$500–600 million a year in official dollar holdings and by about \$400–500 million a year in gold from current production and sales of the Soviet Union. The system broke down after 1957, but not because the United States failed to maintain stability of prices and costs. In fact, the 1958–65 period may have been the most stable in our history. The wholesale price index of industrial goods was virtually unchanged and unit labor cost in manufacturing declined slightly. The balance on current account in 1961–65 averaged nearly \$5 billion a year and was equal to 20 percent of merchandise exports. A comparable surplus now would be \$40 billion.

The U.S. deficits were caused by the enormous increase in capital outflow. From 1951 to 1955, U.S. private foreign investment averaged less than \$2 billion a year and was equal to 15 percent of merchandise exports. U.S. private foreign investment rose sharply after that. In 1961–65, it averaged \$6 billion a year and was equal to 25 percent of merchandise exports. In 1971–75, it averaged \$23 billion a year and was equal to 31 percent of merchandise exports. In the past five years, U.S. private foreign investment averaged \$76 billion a year and was equal to 36 percent of merchandise exports, although the figures are inflated by book transfers of the International Banking Facilities. It should be noted that in recent years the foreign capital inflow, including official funds and unrecorded transactions, was far in excess of U.S. private investment. In other countries the payments difficulties have been aggravated by the widespread and uneven inflation, by the huge increase in the price of oil, and by the burden of debt in some of the developing countries.

No system of fixed parities can function with such a pattern of international payments. The surpluses and deficits on an official reserve basis would have been far beyond the capacity of the monetary authorities to manage. Under the gold standard, it would have necessitated an intolerable deflation in the deficit countries. Under the Bretton Woods system it would have led to an unacceptable monetary expansion in the surplus countries. With the present system of floating rates, it has resulted in large fluctuations in the exchange rates for the major currencies, most notably in the enormous appreciation of the dollar since mid-1980. This has been very disturbing, but it has not been accompanied by an exchange crisis, or worse, that would have been unavoidable with fixed par values.

What remains of the Bretton Woods system that was born here 40 years ago? The Fund is still the center for consultation and cooperation on international monetary problems and it has been very helpful in dealing with the payments difficulties of some countries. But it has not found the right role to carry out its responsibilities in the present system of floating exchange rates. The second amendment to the Articles of Agreement, which formalized the end of the Bretton Woods system, states that "the Fund shall oversee the international monetary system in order to ensure its effective operation." I should like to see the Fund take a more positive view of this responsibility. Perhaps this meeting at Bretton Woods can tell us what the Fund should do.