Bretton Woods: reform proposals for the international monetary system

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The aim of this paper is to propose a critical analysis of the international monetary system, as it resulted from the Bretton Woods Conference in 1944. This analysis will be conducted through the separate presentations of the two most significant reform proposals of that system (the first two chapters). The concluding chapter will describe the institutions created by the conference, and then try to highlight the differences between these institutions and those designed by the two reform plans. Finally, it will expose the author's point of view about the structure of the system itself, highlighting its contradictions.

In the first chapter the English project of reform, written by John Maynard Keynes, will be presented, analyzing the problems he intended to solve with it. A particular attention will be paid to balance of payments disequilibria in the national States, as they were considered the main reason of international conflicts. In fact, since the gold standard, only the debtor countries have been suffering from the burden of adjustment. The explanation of this phenomenon lies on the fact that a debtor country suffered from an outflow of gold (to compensate the asymmetry) that provoked a contraction in money supply. Furthermore, the social cost of this effect is high: this contraction led to lower prices and incomes, and higher unemployment.

On the other hand, the creditor countries did not suffer from any of these problems, as an inflow of gold caused an expansion in money supply. This expansion led to inflation, but at the same time led to higher national incomes and lower unemployment. Moreover, according to Keynes, the adjustment is compulsory for the State in deficit and optional for the State in surplus. In order to solve the problems linked to the mechanism of adjustment, Keyens proposed a system where both the deficit and the surplus countries had to contribute. He suggested a worldwide system of economic and financial relations that could boost the international trade among the States. This system would be the framework of a currency union based on an international currency called bancor. The bancor would have been defined in terms of gold, “but its value was not to be unalterable” (Horsefield. 1969). This currency’s task was to be a mean of payment for international debts. In fact, every central bank would have had an account in an International Clearing Bank: the base of a multilateral clearing system. In this way the states would have had the possibility to pay the debt back in a national currency, due to the parity previously set in terms of bancor. In other words, Keynes tried to propose the national principle of banking at an international level: the central idea was the compulsory equivalence between credits and debts. The surplus country would have had a credit account in the Clearing Bank, vice versa the deficit ones would have had a debit account. The attention was paid to the multilateral level, Keynes abandoned the bilateral vision that during the inter-war period “had provoked a contraction in the international trade”(Findlay and O’Rourke 2009).

The mechanism projected by Keynes, would have avoided that the surplus countries stored money with the correspondent contraction of the global demand, because this money (reproducing the national principle of banking) could be used by other economic agents (the states in this case). This “expansive pressure”(Keynes 1941) was to be the consequence of an “overdraft facility”(Keynes 1941) given to the member States. With this overdraft facility every single State would have had the resources and the time to correct their balance of payments disequilibria. Keynes considered these facilities as fundamental especially in the short-run: the states destroyed by the war, would have needed resources to restore the economy and to facilitate the transaction from a war economy to a peace economy.

The second chapter will focus on the American plans reform written by Harry Dexter White appointed by the U.S. Treasury. This project of reform of the international monetary system was the major alternative to Keynes plan. While the objectives of both the two plans were similar (boosting international trade, recovering the post-war economy, creating an international system of payments), on the one hand, the measures proposed by Keynes were the International Clearing Bank with the generalization of the principle of banking to an international level; on the other hand, White in his work

(“*Preliminary Draft Proposal for a United Nations Stabilization Fund and a Bank for Reconstruction and Development of the United and Associated Nations”*) proposed a system of international monetary and banking cooperation, which should have been reached through the creation of two different institutions: the “*United and Associated Nations Stabilization Fund”* and the “*Bank for Reconstruction and Development of the United and Associated Nation*s”. The first was supposed to provide the necessary tools to achieve exchange rate stabilization. This stabilization was intended to reduce the exchange risk in the international economy and in the financial transactions, in order to develop international trade. Moreover, this institution would have promoted the reduction of trade barriers and tariff: a disturbance for trade and capital flows. In order to reach these objectives the Stabilization Fund would have been able “to buy, sell and hold gold, currencies, and government securities of member countries; to earmark and trasfer gold; to issue its own obligations, and to offer them to discount or sale in member countries” (White 1943). White wanted to create a monetary fund where the member countries’ subscriptions (quotas) were used to give to the states in deficit the chance to face the international obligations. However, differently from Keynes’ plan, in this case the debtor countries should have adjusted the balance of payments disequilibria with no contribution from the creditor ones. Secondly, the International Bank would have had the means to support the economic recovery, to facilitate the transaction from a war economy to a peace economy, and to boost the international trade and productivity. In order to reach these objectives, the Bank should have removed two different obstacles: “the scarcity of foreign exchange and the variations in exchange rates”(White 1943). Nevertheless, this first draft of the White’s plan does not clarify the solutions proposed by the American economist. Firstly, he seemed to suggest a international monetary system similar to the gold exchange standard. Then he thought of a international currency but he did not specify the characteristics of this mean of payment.

In the second proposals “*Preliminary Draft Outline of a Proposal for an International Stabilization Fund of United and Associated Nations*”, instead, he proposed to separate the competences of the two institutions: the Stabilization Fund should have ensured the monetary stabilization during the short term, while the International Bank for Reconstruction and Development would have managed to reach the mid-long term objectives. This second draft also included, as Keynes' one, the project of an international currency, named *Unitas*, aimed to facilitate international trade. That was actually a mere unit of account, useful for a fund, like the Stabilization Fund did, that gathered together different national currencies. In this it was different from Keynes' bancor which had a more active function as explained before.

While the previous chapters discussed the two main proposals of reform of the international monetary system, the third analyze the agreement reached on the basis set by Keynes and White's works. The Bretton Woods Conference, started on the 1st july 1944, which involved more than forty countries, brought to the creation of the international institutions inspired mainly by White's proposal. The International Monetary Fund (IMF) and the World Bank reflect the structures and the objectives of the Stabilization Fund and the International Bank imagined by White. Nevertheless, although this looked as a predominance of United States' plan, the pivotal principal of the international currency did not become effective. By contrast, this international currency has been displaced by the dollar. Through an apparently innocent clause: " *the par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944"* (IMF, *Articles of Agreement,* Art. IV, Section 1) Bretton Woods made a national currency, the dollar, an international one. The dollar, hence, became with gold the only reserve currency, as all the other national currencies were obliged to define their value either in terms of gold or dollars. This scenario permitted the existence of a contradictory mechanism: while the United States could print money and purchase goods from other countries, -and this fact looked as an advantage for all the parties-, on the other hand the USA were in charge to provide an amount of money in order to satisfy the global demand of reserve currency. This system led to a trade-off between growth and stability: in order to assure the first, the USA had to provide the necessary amount of money for the global economy, creating a deficit in their balance of payments, and therefore lowering dollars' international credibility; on the other hand, stability required the maintenance of the balance of payments' equilibrium, excluding in consequence the first choice. The increasing amount of dollars in foreign central banks' reserves is a symptom of United States' debt, and so is positively related with the concern around the stability of dollar's value. Despite the shortcomings mentioned, it is necessary to emphasize that the international monetary system created at Bretton Woods paved the way for the development of trade and international cooperation. In fact, in the twenty years between 1950 and 1970 international trade has experienced growth rates as never before. At the beginning of the XX century (the golden age of the international liberalism) the annual rate of trade expansion was around 3.5%, instead during 1950s and 60s was much higher, with a median level of growth of 7,1%. Obviously Bretton Woods it was not the main reason of this growth, but the multilateral logic and international cooperation, that had inspired the Conference, with the relative desertion of bilateralism, lead off a series of international means of international collaboration (the EEC, the GATT). These institutions were the fundamental elements of that growth.

Although the purpose of this paper has been achieved, a problem still remains open: if the strict and alternative application of one of the reform proposals here described could have created a stable international monetary system. In order to answer this question, a more accurate analysis on the eventual faults of the English and American proposals would be necessary. Further analysis should be also conducted to understand if these eventual faults could compromise the stability of the international monetary system.