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BRETTON WOODS: A RETROSPECTIVE ESSAY

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ABSTRACT

Forty years ago, the Articles of Agreement of the World Bank and the International Monetary Fund were negotiated at Bretton Woods, New Hampshire. The Bank and the Fund were parts of an overall American program designed, by redressing the mistakes of the twenties and thirties, to stimulate international trade and investment so as to raise living standards throughout the world. It was a program based on the dreams of economists and brought to fruition in the One World atmosphere of the administration of Franklin Roosevelt. While their mode of operating has changed, the Fund and the Bank have maintained their international approach and are now able for this reason to intervene in the economies of member countries so as to improve the economy of the world.

BRETTON WOODS: A RETROSPECTIVE ESSAY

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As the Bretton Woods Conference neared its conclusion in July, 1944, there was an atmosphere of gloom. The Soviet delegation persisted in its refusal to agree to a World Bank subscription of $1,200 million, matching, thereby, the Soviet quota in the International Monetary Fund. Acting under strict instructions from Moscow, the delegation indicated reservations on other matters as well. In particular, it wanted guarantees that gold pledged for the Soviet Bank subscription and Fund quota would never actually leave the Soviet Union. It sought assurances that favorable interest rates would be charged on Bank loans for Soviet reconstruction.

Then, at the closing plenary session on July 22, United States Secretary of the Treasury and Chairman of the Conference, Henry Morgenthau, Jr., suddenly received word that the Soviet Union would accept its proposed Bank subscription after all. Morgenthau added to his announcement of this news his belief that this event "is fraught with more significance and more hopeful meaning for the future of the world than any which those of us here have heard so far."[1] To the ovation of the delegates, Comrade M. S. Stepanov, Deputy Peoples Commissar of Foreign Trade and head of the Soviet delegation, stood, bowed and smiled

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1. Department of State, Proceedings and Documents of United Nations Monetary and Financial Conference, Bretton Woods, New Hampshire, July 1-22, 1944 (2 vols.; Washington: United States Government Printing Office, 1948), p. 1108.

with pleasure. He enjoyed the role of jolly good fellow. Indeed, a few moments later, supposing that applause directed to another was actually meant for him, Stepanov stood and bowed again, though he warned that special consideration must be given to countries "which have suffered from enemy hostilities."[2]

The United States Director of Economic Stabilization (later Secretary of the Treasury and then Chief Justice of the Supreme Court), Fred Vinson, quickly moved to amend the articles of the Bank in whatever manner was necessary to make allowance for the change in the Soviet subscription. "We march to victory together," Vinson orated. "We march on the paths of peace together."[3]

The gloom was lifted; the fragile Soviet-Western Alliance had not yet been torn asunder. President Roosevelt sent a message to the delegates which was read by Secretary Morgenthau. It said in part:

> [The delegates] have prepared two further foundation stones for the structure of lasting peace and security. They have shown that the people of the United Nations can work together to plan the peace as well as fight the war.[4]

Lord (John Maynard) Keynes, head of the United Kingdom delegation, concluded his remarks by saying:

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2. Ibid., p. 1112.

3. Ibid., p. 1108. The United States delegation had agreed to increase its Bank subscription to offset the Soviet shortfall. With the last-minute increase in the Soviet subscription, the total capital of the Bank became $9.1 billion, $300 million more than the total capital of the Fund.

4. The New York Times, July 23, 1944, p. 24.

> We have perhaps accomplished something more significant than what is embodied in this final act. We have shown that a concourse of forty-four nations are actually able to work together at a constructive task in amity and unbroken accord. Few believed it possible. If we can continue in a larger task as we have begun in this limited task, there is hope for the world. . . . If we can continue, this nightmare . . . will be over. The Brotherhood of Man will have become more than a phrase.[5]

II

The Bretton Woods Conference did not take place in a world devoid of other news. The Democratic National Convention met in Chicago in July, 1944, and nominated Franklin Roosevelt for a fourth term. While the convention was in progress, Roosevelt met with Admiral Nimitz and General MacArthur in Pearl Harbor to discuss the options of landing ground forces on Formosa (Taiwan) or the Philippines. Russian troops, already in Poland, Lithuania, Rumania and Czechoslovakia, appeared ready to push on to the Danube and across it into Bulgaria and Yugoslavia. Indeed, the Soviet advance was so rapid that the British were uneasy about the implications for Greece and the Balkans. On the Western Front, the British Eighth and the American Fifth armies, having occupied Rome, were advancing northward in Italy toward the Po Valley, and General Patten's Third Army was about to begin its famous end run around Normandy, up the Loire and across the Seine.

The "One World" atmosphere in which the Bretton Woods conference adjourned was under some strain. The Soviet Bretton Woods

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5. The New York Times, July 24, 1944, p. 1.

delegation remained in Washington for discussions about the future of American Lend-Lease assistance to the Soviet Union, but nothing was agreed. The Russians had no flexibility to depart from instructions from Moscow, and the Americans were upset by the concurrent Soviet acquiescence in the slaughter of Warsaw Poles by the retreating German Army.[6]

The Yalta Conference took place in February, 1945, with ostensible accord but underlying tension. Stalin agreed to co-sponsor a conference in April at San Francisco to create a United Nations Organization, and three-power commissions were set up to oversee the formation of new governments in Rumania and Poland. In early March, however, the Russians unilaterally imposed puppet regimes in both these countries. Without consulting the three-power commission on Rumania, Andrei Vishinski, Soviet Deputy Foreign Minister, demanded that Rumanian King Michael dismiss the Prime Minister and accept a Soviet sponsored replacement. The three-power commission on Poland couldn't even agree on which Poles to talk to about a new government. W. Averell Harriman for the United States and Sir Archibald Clark-Kerr for the United Kingdom pressed the case of the Polish government-in-exile in London, but V. M. Molotov, Soviet Commissioner (and Foreign Minister), backed the de facto government in place in Warsaw. The Soviets were as determined then as now to control the governments of adjacent countries.

Two weeks before his death on April 12, 1945, President Roosevelt wrote to Premier Stalin to present the United States point of view about

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6. See Dean Acheson, Present at the Creation (New York: W. W. Norton & Co., 1969) p. 85.

Poland, but the difference of opinion remained unresolved. On April 21, on his way to the San Francisco conference, Soviet Foreign Minister Molotov, who had been reluctant to visit the United States at that time, called upon President Harry Truman in Washington, but the discussion was not harmonious. The deadlock over Poland continued. Molotov objected at San Francisco to the seating of a delegation from Argentina, for Argentina had not declared war against Germany; he was annoyed at Western sponsorship of France as a Big Five power; and he left San Francisco while the conference was still in session -- on May 9, the day after the Germans surrendered.

Three days later, President Truman announced the termination of Lend-Lease assistance to the Soviets, an event which had profound repercussions. During a twelve day visit by Harry Hopkins to Moscow, beginning on May 26, there was a brief period of renewed harmony: Stalin agreed to ratify the United Nations Charter, and a Big Three Conference to be held in Potsdam was arranged. At Potsdam in July, however, Stalin seemed preoccupied with the cessation of Lend-Lease, as he and the new American president agreed on little.

On August 24, 1945, ten days after V-J Day, President Truman, in what he later called his greatest mistake, stunned the British with the announcement that all Lend-Lease assistance was officially terminated.[7] Winston Churchill commented:

> I cannot believe that so great a nation whose lend-lease policy was characterized by me as the most unsordid act in the history

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7. See Ibid., p. 28, and The New York Times February 15, 1950. For a moving account of the reaction of Lord Keynes and of important Americans then in London, see R. F. Harrod, The Life of John Maynard Keynes (New York: Harcourt Brace & Company, 1951), pp. 595-96.

> of the world would proceed in such a rough and harsh manner as to hamper a faithful ally. . . .[8]

It had been assumed by the British that Lend-Lease assistance would continue for sometime after the unconditional surrender of Japan. Indeed, it was because of that assumption that the British agreed to maintain their economy essentially on a war-time basis following the German surrender, and why definitive plans for emergency American reconstruction assistance to its wartime allies were not more fully developed when the war ended.

Part of the difficulty was that the Japanese surrender took place sooner after the German surrender than anyone had foreseen (eighteen months was an assumed period for "Phase Two"), but Big Three negotiations about the extent of American Lend-Lease assistance and its termination had always been vague. As early as June, 1942, during a conference with V. M. Molotov about a second front, Harry Hopkins, who initially managed the Lend-Lease program and was a close confident of President Roosevelt, asked Roosevelt if he wanted then to discuss a special post-war fund for reconstruction,[9] but the issue was put off.

The continuation of Lend-Lease assistance after V-E day, at least to the British, was considered, but not agreed to at the Quebec Conference in September, 1944. The continuation of Lend-Lease _after the cessation of hostilities_ was among the bold moves Harry Hopkins believed necessary if the world economy was to be restored and developed in accordance with Roosevelt's goals as set forth in the Atlantic Charter and Article VII of

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8. _The New York Times_, September 25, 1945, p. 5.

9. Robert E. Sherwood, _Roosevelt and Hopkins_ (New York: Harper & Brothers, 1948), p. 572.

the Master Lend-Lease Agreement.[10] But the possibility of a Lend-Lease program to finance reconstruction died with Franklin Roosevelt in April, 1945. So, for all practical purposes, did Big Three cooperation. Roosevelt had preferred to negotiate the biggest issues directly with other heads of state, and he had confided his intentions and personal commitments to few.

In the fall of 1945, after the termination of Lend-Lease, many nations, including the Soviet Union, sought reconstruction loans from the United States government, but only the British application was submitted to Congress and acted upon favorably. Other governments were told to look to the Export-Import Bank whose lending capacity was increased on August 4, 1945, from $700 million to 3.5 billion, or to the as yet unborn International Bank for Reconstruction and Development.

The Soviet Union failed to meet the December 31, 1945, deadline for ratification of the Bretton Woods Agreements. Soviet observers attended the Inaugural Meetings of the Bank and the Fund in April, 1946, at which the deadline for ratification by charter members was extended to December 31, 1946. But the Soviet Union never joined.

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[10] Ibid, p. 819. See also Cordell Hull, The Memoirs of Cordell Hull (New York: Macmillan, 1948) pp. 1613-1614, and Harrod, pp. 586-91. In 1950, an eminent British economist who asked not to be identified told me that, in high level British government circles, it was supposed that there would be a general postwar Lend-Lease settlement among the Allies based on some estimate of their relative contributions to the war effort. For an interesting discussion of the concept of pooling resources in an all-out war effort without regard to financial accounting see Jean Monnet, Memoirs, (Garden City, New York: Doubleday & Company, Inc., 1978) pp. 17-26; 53-77; and 150-69. During World War II Professor E. F. Penrose suggested that Lend-Lease be made retroactive so that the United States might reimburse the United Kingdom

The "One World" dream of Franklin Roosevelt, Wendell Wilkie and the United States Treasury Department was over. As George Kennan was later to observe:

> . . . nowhere in Washington had the hopes entertained for postwar collaboration with Russia been more elaborate, more naive, or more tenaciously (one might almost say ferociously) pursued than in the Treasury Department.
>
> Now at long last, with the uncomprehensible unwillingness of Moscow to adhere to the Bank and the Fund, the dream seemed to be shattered, . . .[11]

The war-time cooperation which united the military opponents of Hitler was probably necessary to induce the subsequent peace-time economic cooperation, but it was not enough to preclude the Cold-War antagonisms of the United States and the Soviet Union. Aside from a commitment to super-national authority, the only inducement to Soviet membership in the World Bank was the prospect of a huge reconstruction loan on favorable terms. Membership in the Monetary Fund did not seem important: since the Soviet Union does not incur "temporary balance-of-payments deficits" in the usual sense, protecting their gold seemed more important to the Soviets

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for British investments in the United States liquidated to pay for war supplies <u>before</u> Lend-Lease assistance officially began. See E. F. Penrose, <u>Economic Planning for the Peace</u> (Princeton, New Jersey: Princeton University Press, 1953), p. 17. For an illustration of isolationist reaction to the Lend Lease Act, see Arthur H. Vandenberg, Jr., editor, <u>The Private Papers of Senator Vandenberg</u> (Boston: Houghton Mifflin Company, 1952), pp. 9-12. In his diary, on March 8, 1941, Senator Vandenberg wrote about the Lend-Lease Act: "If America 'cracks up' you can put your finger on this precise moment as the time when the crime was committed." Vanderburg subsequently became a staunch supporter of a bipartisan, internationalist foreign policy.

11. George Kennan, <u>Memoirs 1925-1950</u>, (Boston: Little, Brown, and Company, 1967), pp. 192-3.

than short-term loans from the Monetary Fund. Control of Eastern Europe seemed more important to Stalin than membership in Western dominated international economic organizations. Thus, when Europeans gathered in Paris in June, 1947, to respond to Secretary-of-State George Marshall's offer of massive reconstruction assistance, Soviet Foreign Minister V. M. Molotov arrived with eighty advisors, only to leave shortly thereafter refusing to cooperate in an enterprise which would infringe on Soviet sovereignty.

It can, of course, never be known whether a continuation of Big Three cooperation would have induced the Soviet Union to participate in the World Bank and the Monetary Fund, nor can it be known how those organizations might have evolved with the Soviet Union as a member. Participation would have brought the Soviets many problems, and the organizations themselves might have been torn assunder by centrifugal force. On the other hand, a world-wide commitment to increased trade and the reduction of poverty might have borne more fruit in the absence of Cold-War antagonisms and a nuclear arms race. In time, Soviet leaders might have opened their economy to western inspection and influence and reduced their messianic pugnacity. They might have become less fearful of the West and, therefore, less belligerent. Given the antagonisms of the interwar years, the paranoia of Soviet leaders, and the impatience of Western governments, however, the Soviets decided that the costs of cooperation with the West exceeded the benefits, and they withdrew behind the "Iron Curtain," dragging their neighbors with them.

III

In a sense, the attempt to include the Soviet Union in post-war economic planning was a quirk of fate. The American and British experts who drafted economic plans for the post-war world labored in a united-nations atmosphere. They supposed, that is to say, that all of the nations united against the Rome-Berlin-Tokyo axis should be included in whatever political and economic organizations might emerge after the war. After June 21, 1941, when Hitler's troops invaded Russia, therefore, it came to be supposed that Soviet, British and American peace aims were, or could be made, as harmonious as their war aims. But the Bretton Woods organizations were designed to serve market-oriented, as distinct from state-controlled, economies, and they sought particularly to redress the American and Western European mistakes of the inter-war, particularly the depression, years.

Together with many Americans, President Roosevelt regretted the unwillingness of the United States to participate in the League of Nations and sought, when the time was right,[12] to reverse that decision by sponsoring a United Nations Organization committed to reducing international political (and military) competition and to improving the lot of people everywhere in the world. As a practical politician, Roosevelt also sought to win the support of uncommitted nations in the struggle against Germany, Italy and Japan. Thus, well before the

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12. He was unwilling to include any reference to an international organization in drafts of the Atlantic Charter. See Sherwood, p. 359.

Japanese attack on Pearl Harbor, in his Third Inaugural Address (January 6, 1941 -- just eight days after the Fireside Chat in which he introduced the concept of Lend-Lease and declared that "We must be the great arsenal of Democracy"), Roosevelt promised a post-war world based on Four Freedoms: Freedom of speech and expression; Freedom to worship, Freedom from want, and Freedom from fear.

Though negotiations with the British about the wording of the Master Lend-Lease Agreement dragged on for nearly a year thereafter,[13] the first Lend-Lease appropriation was passed by the Congress in March, 1941. The Atlantic Charter was agreed to by Roosevelt and Churchill at sea, off the coast of Newfoundland, in August, 1941. The United States and the United Kingdom, after the Nazis had been defeated, would "endeavor, with due respect for their existing obligations, to further the enjoyment by all states, great or small, victors or vanquished, of access, on equal terms, to the trade and raw materials of the world which are needed for their economic prosperity."

Article VII of the Master Lend-Lease Agreement, which was eventually signed bilaterally by the United States and fifteen other governments -- including the Soviet Union, specified that the terms of a Lend-Lease settlement "shall be such as not to burden commerce between the two countries but to promote mutually advantageous economic relations between them and the betterment of world-wide economic relations. To

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13. The difficulty lay in the reluctance of the British to negotiate away imperial preferential tariffs. See Acheson, pp. 27-34, and Harrod, pp. 515-17.

that end, they shall include provision for agreed action . . . directed to the expansion, by appropriate international and domestic measures, of production, employment, and the exchange and consumption of goods, which are the material foundations of the liberty and welfare of all peoples; to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers . . . ." The contracting parties further stipulated that "at an early convenient date, conversations shall be begun . . . with a view to determining, in the light of governing economic conditions, the best means of attaining the above stated objectives . . . ."

The post-war planners not only labored in a united-nations atmosphere, they labored in an atmosphere of contemplated freer trade. Much of the hardship of the depression was blamed on nationalistic politics which had sought to decrease each nation's imports, thereby exporting unemployment. Western economists had long taught that the greatest prosperity of the world and its component parts could be achieved only if barriers to trade were removed, and the post-war planners set out to make this dream come true.

Eliminating discriminatory treatment in international commerce and reducing tariffs and other trade barriers were long-standing goals of the State Department, of Secretary-of-State Cordell Hull in particular. Indeed, between 1943 and 1945, State Department experts drafted a charter for an International Trade Organization (I.T.O.) which would have overseen the reduction of trade barriers and trade discrimination. The charter was modified at various international

meetings and finally agreed to by representatives of fifty-three nations at a conference in, of all places, Havana, Cuba, in March, 1948. By that time, however, the Cold War was well underway and the political composition of the United States Congress had changed from what it had been in the Roosevelt era. The charter was resoundingly condemned by the Soviet Union, and then, by inaction, rejected by the Congress of the United States. The Soviet Union preferred bilateral to multilateral trade bargaining and argued that free international trade would only strengthen control of the world by capitalist nations. The American Congress was concerned that the I.T.O. Charter dealt with too many subjects and, with a one-nation one-vote system similar to that of the United Nations, provided the United States with too little voting power.

The General Agreement on Tariffs and Trade, negotiated among thirty-three countries in 1947 as an interim agreement on international commercial policy until the I.T.O. came into existence, then became a permanent, renewable accord under the auspices of which various rounds of tariff cutting negotiations have been held. Thus, the commercial policy objectives of the International Trade Organization have been largely attained through informal machinery to which the President of the United States can adhere under the provisions of Reciprocal Trade Agreement legislation. (The President is enjoined not to reduce tariffs so much as to injure American industry, however, unless he explains his action to Congress.)

State Department experts were not only concerned with issues of

protection, trade discrimination, trade between governments, cartels and restrictive business practices, they were concerned about foreign-exchange controls and, therefore, foreign-exchange rates and markets. In the early depression years, trade had been disrupted not only by import quotas and rising tariffs but also by competitive currency depreciations and blocked foreign-currency accounts. But foreign-exchange issues were the concern of the Treasury Department.

IV

In 1934, it became illegal for Americans to hold gold. Even the Federal Reserve Banks were obliged to sell their gold to the United States Treasury, receiving gold certificates or bookkeeping claims against Treasury gold in return. Only the Treasury could legally keep gold not used in industry. The Secretary of the Treasury was also instructed by Congress to buy silver so long as its stocks of silver were less than one-fourth of the total value at official prices of gold and silver combined. A $2 billion Exchange Stabilization Fund created in 1934 was placed under the authority of the Secretary of the Treasury. The Treasury Department became the official manager of United States gold and, therefore, together with the Federal Reserve System, of the external value of the dollar.

In 1934, a Division of Research and Statistics was established within the Treasury, the staff of which gathered data and prepared reports on such subjects as "The Supply of Gold and Silver Appropriate to our Monetary Needs," "Should U. S. Establish a Free Gold Market?,"

Why Has the U. S. Acquired So Much Gold?," and "Studies of the International Competitive Positions of Various Countries."[14] It was within this Division, directed by Dr. Harry White (a brilliant, young, Harvard Ph. D. who, in 1945 became Assistant Secretary of the Treasury) that the initial American plans for a World Bank and a Monetary Fund were drafted.

For roughly thirty-five years before World War I and again in the late 1920s, the major currencies of the world were tied to each other through gold. So long as gold was freely exchangeable by central banks and treasuries for domestic currencies at fixed prices, the external values of various currencies were established. But this system was interrupted by World War I, following which, in the early twenties, some currencies, most notably the French franc, fluctuated freely -- buffeted, as it was supposed at the time, by speculation as well as by changes in the underlying factors affecting the volume and direction of international trade and investment. In 1931, when the Bank of England ran out of gold, the gold-exchange system collapsed. The Bank of England no longer bought and sold gold at permanently fixed prices, and the external value of sterling fluctuated more or less freely in response to basic balance-of-payments forces.

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14. Copies of these and other studies may be found among the personal papers of Dr. Harry White (The White Papers) in the Princeton University Library. For information about Dr. Harry White, see David Rees, Harry Dexter White (New York: Coward, McCann and Geoghegan, 1973]; Nathan I. White, Harry D. White -- Loyal American (published privately by Bessie (White) Bloom, 1956); and John Morton Blum, Roosevelt and Morgenthau, a Revision and condensation of From the Morgenthau Diaries (Boston: Houghton Mifflin Company, 1970).

During the thirties a new device for managing exchange rates (and sterilizing gold imports) began to be used. In the United States and many continental European countries, it was called an Exchange Stabilization Fund; in Great Britain, the Exchange Equalisation Account. These funds consisted of assets (gold or government bonds) which could be used to deal in foreign currencies, thus influencing exchange rates. They were managed by governments or central banks to offset speculation, which induced undue day-to-day fluctuations in exchange markets; to sterilize the domestic monetary effects of purchases or sales of foreign exchange or gold; and to keep foreign exchange rates at levels regarded as more or less "correct" from a national point of view.

The prototype fund was the British Exchange Equalisation Account which was established in 1932, shortly after the Bank of England had been relieved by Parliament of the obligation to sell gold on demand at a fixed sterling price. The Account was owned by the British Treasury but managed by the Bank of England. Initially, it could only buy foreign currencies -- it had no foreign currencies to sell, so it could prevent the pound from rising but not from falling. Over time, however, as it acquired gold-convertible currencies (first dollars then French francs), it acquired gold which it could resell as needed to prevent the pound from falling. So long as it had both gold and treasury securities, it could stabilize the foreign-exchange value of sterling at a desired level.[15]

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15. Shortly after the E.E.A. was established, an inflow of short-term funds strengthened the pound; the E.E.A. was able to acquire a substantial stock of gold while selling sterling so as to prevent the pound from rising.

For its part, the American Fund started with gold with which it could acquire dollars from the U.S. Treasury.[16] Occasionally it bought pounds or francs in order to keep the dollar from rising, but it immediately sold these foreign currencies for gold with which it replenished its stock. It never reversed this operation, however, and could not keep the dollar from falling.

In the early days of the New Deal, the external value of the dollar fell as the dollar price of gold rose or, as some prefer to say, the dollar was devalued. In 1933, the external value of the dollar seemed unimportant; the domestic price level was of primary concern. It was supposed that a way out of the depression was to restore pre-depression prices, and that prices would rise as the price of gold rose. During 1933 and 1934, the dollar price of American imports and import competing goods did rise. So did production, but the depression continued, and, though he still had the authority, the President lost interest in further changing the price of gold. The dollar price of gold remained at $35 an ounce from January, 1934, until December, 1971.

By 1936, it began to appear that the dollar might become overvalued relative to other currencies as a result of managed currency depreciations (increases in the foreign currency prices of gold) abroad. The dangers of trade discrimination inherent in the use of exchange controls as practiced by countries (e.g. Germany) with overvalued

16. The dollar value of Treasury gold rose by almost 70% between April, 1933 and February, 1934. Two billion dollars of this book-keeping profit was transferred from the Treasury to the Stabilization Fund.

currencies were also beginning to be appreciated. Thus, Treasury (and State) Department officials began to think in terms of an international currency stabilization agreement consistent with balance-of-payments equilibrium. The objective was to preserve for the United States a bit of the competitive edge which had resulted from the 1933-34 devaluation while providing an international exchange-rate system compatible with international free trade.

On September 25, 1936, Secretary of the Treasury, Henry Morgenthau, Jr., announced a Tripartite Agreement between the British, French and Americans under the terms of which the three governments agreed to consult with each other about pound-franc-dollar exchange rates. They also agreed to maintain the gold values of their respective currencies for periods of twenty-four hours so that their respective funds could intervene in exchange markets on a daily basis without the risk of losing gold. After affirming a "common desire to foster those conditions which safeguard peace and will best contribute to the restoration of order in international relations . . . ", Secretary Morgenthau invited "the cooperation of other nations to realize the policy laid down in the present declaration."[17]

Given international consensus on the desirability of maintaining equilibrium and reasonably stable exchange rates,

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17. Annual Report of the Secretary of the Treasury on the State of the Finances for the fiscal year ended June 30, 1937, Washington, D.C: United States Government Printing Office, 1938), pp. 258-59.

prototype exchange stabilization funds, and the willingness of the United States to maintain a constant dollar price for gold and to pay gold to foreign governments and central banks on demand,[18] the basic ingredients for an international monetary fund were available. A combined U. S.- U. K.- French stabilization fund could have been instituted in 1936 to intervene in foreign exchange markets as needed to maintain exchange-rate stability on a day-to-day basis while exchange rates fluctuated in response to longer run market forces.

Such a fund could have been augmented by internationally acceptable assets contributed by and, therefore, available to other governments willing to abide by the agreement. But it took the common purpose of the war and the specific instrument of the Lend-Lease agreements to induce such an accord. Details had to be worked out. How large a fund was needed, initially, and in the future? What portion of the fund should each member nation contribute and be able to use, and under what circumstances? When should exchange rates be allowed or induced to change? To what extent should the managers of the fund concern themselves with national policies and actions which might affect international payments? In the determination of the policies of the fund, how many votes should each government have? What peculiar advantages and obligations might accrue to the United

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18. This third condition was not essential. It was dropped from the international monetary system on August 5, 1971, when President Nixon closed the American gold window -- when, that is to say, President Nixon ordered the Treasury Department to refrain from selling gold to foreign governments, central banks and the International Monetary Fund for dollars at any price.

States as a result of its commitment to sell gold on demand for dollars held by foreign central banks and governments?

V

Shortly after the British and American Lend-Lease discussions began in the spring of 1941, Dr. Harry White set out to draft a "Suggested Plan for a United and Associated Nations Stabilization Fund and a Bank for Reconstruction and Development of the United and Associated Nations."[19] "No matter how long the war lasts nor how it is won," White wrote in the draft he presented to Secretary Morgenthau on May 8, 1942, "we shall be faced with three inescapable problems: to prevent the disruption of the foreign exchanges and the collapse of monetary and credit systems; to assure the restoration of foreign trade; and to supply the huge volume of capital which will be needed virtually throughout the world for reconstruction, for relief, and for economic recovery."

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19. According to Frank Coe (personal interview, August, 1950), White first showed colleagues in the Treasury Department a draft of his plan in the late summer or early Autumn, 1941. It was an outgrowth of a plan for an Inter-American Bank on which White had worked in 1939. See Robert W. Oliver International Economic Co-Operation and the World Bank (London: Macmillan, 1975), pp. 92-99. See also Richard N. Gardner, Sterling-Dollar Diplomacy, expanded edition (New York-McGraw-Hill Book Company, 1969) p.73. On December 14, 1941, one week after the Japanese attack on Pearl Harbor, Secretary Morgenthau formally asked White to work on plans for a fund and a bank. See Armand Van Dormael, Bretton Woods (New York: Holmes & Meier Publishers, Inc., 1978), pp. 40, 45. A copy of the draft cited here (April, 1942) may be found among the White Papers. It has been reproduced as Appendix A of International Economic Cooperation and the World Bank.

Clearly the task can be successfully handled only through international action . . . . It is high time that . . . plans be drafted . . . . Such agencies should, of course, be designed to deal chiefly with postwar problems. But their establishment must not be postponed until the end of hostilities . . . .

. . . . No one knows how soon the war will end, and no one can know how long it will take to get plans approved and the agencies started. Yet, if we are to 'win the peace,' which will follow the war, we must have adequate economic instruments with which to carry on effective work as soon as the war is over . . . .

. . . there is an additional important reason for initiating at once serious discussion of specific proposals. Such a discussion will be a factor toward winning the war . . . . The people of the anti-axis powers must be encouraged to feel themselves on solid international ground, they must be given to understand that a United Nations victory will not usher in another two decades of economic uneasiness, bickering, ferment, and disruption . . . .

Finally, they must have assurance that the United States does not intend to desert the war worn and impoverished nations after the war is won, but proposes to help them in the long and difficult task of economic reconstruction.

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A vital part of that promise rests on international monetary and banking collaboration. The United Nations and the Nations associated with them must undertake co-operatively two tasks as soon as possible; first, to provide an instrument with the means and procedure to stabilize foreign exchange rates and strengthen the monetary systems of the United Nations; and second, to establish an agency with resources and powers adequate to provide capital for economic reconstruction to facilitate rapid and smooth transition from wartime to peacetime economies, to provide relief for stricken peoples during the immediate postwar period, to increase foreign trade and permanently increase the productivity of the United Nations.

These two tasks should be kept distinct. Though in some of their facets and in many of their consequences there is considerable interdependence and interaction, the two are different enough to call for separate instrumentalities . . . . To supply the United Nations with necessary capital not otherwise available except possibly on too costly terms should be the function of a bank operated for that specific purpose; whereas monetary stabilization . . . would best be performed by a stabilization fund created to perform that special function.

It is therefore recommended that immediate consideration be given to formulating plans for the establishment of two separate institutions:

1. A United and Associated Nations Stabilization Fund, and

2. A Bank for Reconstruction and Development of the United and Associated Nations.

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It will perhaps help toward understanding and induce a more sympathetic approach to the proposals which follow to state at the outset that something much more than the usual banking and stabilization functions are envisaged in the plan. There is urgent need for instruments which will pave the way and make easy a high degree of co-operation and collaboration among the United Nations in economic fields hitherto held too sacrosanct for international action or multinational sovereignty, a breach must be made and widened in the outmoded and disastrous economic policy of each-nation-for-itself-and-the-devil-take-the-weakest. Just as the failure to develop an effective League of Nations has made possible two devastating wars within one generation, so the absence of a high degree of economic collaboration among the leading nations will, during the decade, inevitably result in economic warfare that will be but the prelude and instigator of military warfare on an even vaster scale.

Following this introduction, White presented outlines of his proposed fund and bank. While they were less detailed than the Articles of Agreement negotiated at Bretton Woods, they were, in the main, similar.

Of the two proposed organizations, the Fund was the more central to American policy. The Treasury (or Central Bank or Stabilization Fund) of every member country would have the privilege, at its own discretion, of purchasing from the Fund (with its own currency) any currency held by the Fund, provided:

a. The currency demanded from the Fund is required to meet adverse balance of payments to the country whose currency is being demanded.

b. The sum in the Fund of the currency of the country making the purchase shall be, after adding the sum proposed to be purchased, not more than 100 percent of the total sum -- gold, currency, and notes -- originally contributed to the Fund.

c. The rate of exchange shall be the one determined by the Fund.

Each country was assigned a quota or subscription of which 25 percent would be paid to the Fund in "cash" -- one half in gold and one half in local currency. Another 25 percent would be paid in interest-bearing government securities which, presumably, could be sold by the Fund for local currency or gold. The remaining 50 percent would be callable by the Fund in such form and rate as it might choose. It would appear from this formula that a member government might purchase, at its own discretion, other currencies equal, at official exchange rates, to 87 1/2 percent of the local currency value of its quota.

Beyond that, the Fund, at its discretion, might purchase more of the deficit country's currency, presumably with gold or other currencies, as long as

a. It is believed the anticipated balance of payments of the country in question was such as to warrant the expectation that the "excess" would be disposed of within a reasonable time, or

b. The country in question had gold holdings which, together with gold it expected to accumulate within a reasonable time, were adequate to replace the excess, and

c. The country in question agreed to adopt and carry out measures designed to correct the disequilibrium in the countrys balance of payments, which the Fund recommended -- after careful examination of the situation.

In short, the International Monetary Fund would do for each member government much of what a national stabilization fund

might do to defend its national currency against depreciation. The Fund, at its discretion, could do more, though the Fund could act only with the approval of four-fifths of the votes of the member governments.

A noteworthy feature of this early draft (and of the final agreement) was the absence of any real discussion of the circumstances under which a member government could induce or should allow the value of its currency to decline. White sternly specified that "The Fund would fix the rates at which it will exchange one member's currency for another, and the rates at which it will buy and sell gold with local currencies. The guiding principle in the fixing of such rates shall be stability in exchange relationships. Changes in rates shall be made," wrote White in words destined to induce many more words of interpretation, "only when essential to correct a fundamental disequilibrium, and only with the consent of four-fifths of member votes" (underlining added). White was anxious to prevent competitive devaluation in the post-war world, but he did not discuss fundamental disequilibrium. As a result, surprisingly in retrospect, he authored an institution which, for at least two decades, countenanced many overvalued currencies (including the dollar) which no one quite knew how or when to adjust downward, or by how much.

It is also a bit surprising that relatively little attention was paid to the rationale of the quotas assigned the member countries, or to the total. It must be remembered, of course, that the Fund was not designed to finance the total foreign trade of its members; it was

designed only to finance the excess imports at current exchange rates of countries having temporary import surpluses (i.e. temporary basic balance-of-payments deficits). It was not designed to finance excess imports associated with post-war reconstruction or long-run development or due to permanently inappropriate (inflationary) domestic fiscal or monetary policies. Indeed, it was largely because White's final plan was more restrictive in this regard than the alternative Keynes Clearing Union that the United States government favored the White plan. Even so, the extent to which a country may need special financing to pay for an unexpected and temporary balance-of-payments deficit depends not only on such obvious factors as the normal volume of its foreign trade and, perhaps, its normal total production, but also on such other factors as the nature of its exports and imports, the cyclical instability of its trading partners, the instability of relevant world prices, the anticipated rate of its economic development, and the extent of its reserves and borrowing capacity aside from its access to the fund.

Factors such as these were not taken into account. White's initial proposal suggested that the quotas (and voting power) in the Fund, like the subscriptions (and voting power) in the Bank, should be determined by a formula based on national income. The British argued that the volume of a nation's foreign trade was more important, and, in the end, the quotas in the Fund and the subscriptions to the Bank took into account national income and foreign trade and national pride.[20] But the result

20. Fund quotas and Bank Subscriptions were based upon 4 percent of 1940 national income and 6 percent of the sum of average exports and imports, 1934-1938. They were adjusted somewhat at Bretton Woods to

was an uneasy compromise, for some Fund quotas have been obviously inadequate, and the working Fund has frequently been obliged to arrange for supplementary emergency financing.

But what of the total quotas in the Fund? In 1941, White thought the quotas should aggregate $5 billion. At Bretton Woods they were established at $8.8 billion ($10 billion for the world). In 1940, according to White's calculations, the national income of the United Nations was $165 billion, and the annual average of world trade (exports plus imports) in the three pre-war years was $48 billion. In 1982, the national income of the members of the International Monetary Fund was over $10 trillion; world trade was over $3 trillion. If the Fund were still trying to stabilize relatively fixed exchange rates, and if the relationships between Fund quotas and either national income or world trade were roughly correct in 1941 or 1944 -- and 1983, Fund quotas in 1983 should have aggregated between $300 and $500 billion. The $60 billion actually available was inadequate to finance a fixed-but-adjustable exchange-rate system, and such a system no longer existed.

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suit national proclivities. Nations likely to be debtors sought small subscriptions, and nations likely to be creditors accepted larger subscriptions. But a great deal of emotion was expressed during the negotiations, in part because voting power, and therefore prestige, was related to the size of quotas and subscriptions. In the Fund, moreover, the amount of foreign exchange a member can purchase in normal circumstances, depends on the size of its quota. In the Bank, on the other hand there is no relation between the size of subscriptions and borrowing rights. Thus many nations wanted large quotas in the Fund and small subscriptions to the Bank. For its part, the Soviet Union wanted to be recognized through its Fund quota and Bank subscription as one of the Big Three; France as one of the Big Five. See Van Dormael, pp. 179-95; and John Morton Blum, _From the Morgenthau Diaries_ Vol. III, _Years of War_ (Boston: Houghton Mifflin Co., 1967), pp. 257-71.

VI

In accordance with Harry White's 1941 formula, the total foreign exchange which deficit nations could have bought from the Fund at their own discretion would have been in the order of $4 billion, the exact amount depending a good deal on the ability of the Fund to acquire currencies with gold and gold with government securities. Since the United States Exchange Stabilization Fund had $2 billion in gold and the British Exchange Equalization Account had assets and a line of credit valued after April, 1937, at £567 million (roughly $2.7 billion), the total proposed fund for all of the United Nations was not large. But White assumed his Stabilization Fund would be supplemented by an International Bank which could make or guarantee long-term loans to finance the larger, long-term trade deficits of nations needing special assistance for post-war reconstruction or longer term development.

White's proposed International Bank for Reconstruction and Development would have had capital subscriptions aggregating $10 billion of which $5 billion would have been paid in (half in gold and half in local currency), the other half being callable if and as needed by the bank to cover defaults. In addition, the Bank would have been permitted to issue its own "demand currency notes" backed by the paid-in securities of member governments and by gold. Assuming, as White obviously did in 1941, that the notes of the International Bank would be accepted by member central banks in exchange for the local currency needed to pay for that country's exports, these notes would have served

the same function as newly mined gold in an international gold standard system or as S. D. R.s in today's international exchange system: they would have been net additions to world money. Depending on the ability of the Bank to obtain more gold as backing for these notes (or a reduction in the 50 percent gold backing requirement), the lending capacity of the Bank could have been several times the Bank's total subscription.

The demand currency notes, which White sought to call "Unitas," were deleted from the draft proposals which made their way within the government from department to department in 1943.[21] They would sound too radical to Congress, it was thought. But the same general result could have been obtained (could still be obtained) if the Bank could sell its own bonds (or guarantee private bonds) having an aggregate value of several times the unpaid capital subscriptions of member governments. In this way, the Bank could have obtained funds needed for direct loans, or could have guaranteed private loans aggregating more than the total subscriptions to the Bank. Thus, the purchasing power of the world would have been increased.

The difficulty was that the Bretton Woods delegates decided that the lending and guaranteeing capacity of the Bank should

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21. White later suggested that the name "Unitas" be applied to the accounts of the International Monetary Fund. Keynes suggested "Bancor" for his Clearing Union. At Bretton Woods the United States dollar was chosen instead only to be supplanted in 1967 by "Special Drawing Rights."

not exceed the total subscriptions.[22] Over the years, therefore, as a substitute, the subscriptions to the Bank have been periodically increased (as have the quotas in the Fund), and this has enabled the Bank to increase its lending and guaranteeing capacity. (It has also subjected the Bank and the Fund to periodic political harrassment by national legislatures, particularly the Congress of the United States!)

Since White supposed that this procedure would be followed if the Bank were successful, he was not greatly upset by the imposition of a lending ceiling. In an elaboration of the August 2, 1943, draft of his Bank plan, however, White insisted that "Asia, Europe, Africa and South America can for many years profitably use for the creation of capital goods $5 to 10 billion of foreign capital each year provided they can get it on reasonable terms. . . ."[23] Thus, it is clear that in 1942 White was proposing an international lending institution with far more lending capacity than the Bank which emerged from Bretton Woods. The Fund could be small and specifically directed, White believed, because the Bank would be large and more broadly oriented.

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22. As a practical matter, the lending ceiling was even smaller for many years, for the Bank could market its bonds (and, therefore, obtain more loanable funds) in any given country only to the extent that the unpaid subscription of that government served as backing for that particular bond issue.

23. See the White Papers. Given the circumstances of the war years, this was a remarkably accurate forecast. In 1965, Irving Friedman, Economic Advisor to the President of the World Bank, concluded that $3 to $4 billion of additional development finance at 1965 prices could be used annually by developing countries for the foreseeable future. See Oliver, p. 275.

Of more importance to White (and to the working Bank) than the sources of its funds were the conditions under which the bank could make or guarantee loans. White was very specific: the bank could make short-term and long-term loans to any participating government and to political sub-divisions or business enterprises therein, [only] provided:

a. The servicing of the loan is fully guaranteed by the national government.

b. The funds cannot be borrowed from private investors except at high rates of interest.

c. The loan is made only after a careful study and written report by a competent committee on the merits of the project and the loan.

d. Only when the Committee's report definitely indicates that the loan would serve directly or indirectly to permanently raise the standard of living of the borrowing country, except where the purpose of the loan is to provide emergency relief for devastated areas of war-impoverished inhabitants.

e. Only at very low rates of interest -- preferably not higher than 3 percent, with a schedule of repayment appropriate to the project.

Furthermore, "whenever possible the Bank should guarantee loans made by private investors, instead of making loans directly."

As with the Fund proposal, the Bank proposal sought to solve the problems of an earlier time, for the recent international lending experience of American investors, public and private, had not been altogether happy.

At least until the 1870s, the United States was a "less developed" or "newly developing" country whose annual import surpluses were financed by foreign investors. After the 1890s, however, the long-term foreign debt of the United States began to decrease. Then,

during World War I, as the European allies borrowed heavily to finance wartime American exports, the United States suddenly became the world's second (to the U.K.) greatest creditor nation.

During 1919, private American loans to refund some war debts were important, and in 1920 a tidal wave of private American overseas investing began. In 1914, net foreign investments in the United States aggregated approximately $5 billion. By 1928, the net private long-term claims of the United States against the rest of the world totaled some $18 billion, to which can be added $10 billion of war debts owed the United States government. About 35 percent of the private American loans were to Canada, 25 percent to Latin America, and the rest to Europe.

The flow of American capital to Europe was criticized with prescience in 1922 by John Maynard Keynes, and the scope of his concern might have been broadened:

> . . . . If European bonds are issued in America on the analogy of the American bonds issued in Europe during the nineteenth century, the analogy will be a false one; because taken in the aggregate, there is no natural increase, no real sinking fund, out of which they can be repaid. The interest will be furnished out of new loans, so long as these are obtainable, and the financial structure will mount always higher, until it is not worth while to maintain any longer the illusion that it has foundations. . . .[24]

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24. J. M. Keynes, A Revision of the Treaty (London: Macmillan and Co., Ltd., 1922), pp. 161-62. There is some reason to suppose that Keynes' warning might have had some relevance to overseas lending in more modern times, though there is no reason in theory why only "new" countries can generate enough "profits" from the use of borrowed capital to repay foreign lenders with interest and still be more wealthy than otherwise. As a practical matter, moreover, capital often flows from poor to rich countries because the savers in poor countries fear the loss of their capital if they invest at home.

The illusion was indeed shattered after 1929 when the export of long-term American capital declined precipitously, and European governments defaulted on their war debts. In the early thirties, the outflow of dollars declined further because of the depression and the Smoot-Hawley tariff. The predictable result was a wave of foreign defaults on dollar obligations, international animosity, and Congressional inquiries into causes.

Defaults on private obligations began in 1931 with the suspension of interest on over $500 million of dollar bonds owed by foreigners. In 1933, over $1 billion went into default. By 1935, sixty percent of Latin American bonds were in default as to interest payments. Interest was paid in full during the entire depression on almost two-thirds of all foreign (including Canadian) bonds held privately by Americans, but the American resentment of foreign defaults, particularly defaults by governments on the war debts, was substantial.

The most obvious cause was the huge, sudden reduction in the outflow of dollars as American imports and overseas lending declined. But other problems were identified. Some investment bankers employed thousands of local agents to sell foreign bonds on commission to small investors in the mid- or far-west while paying no attention to the way in which the money was spent by the foreign borrowers. The commissions charged by some bankers were so large that the de facto interest paid by borrowers on funds actually received was very high. Some borrowers, Latin American governments in particular, financed some projects which did not

increase the overall productive capacities of their countries. Much private American lending to European governments in effect merely refinanced war-time inter-governmental obligations.

On balance, American attitudes about international investment were much altered because of the defaults. During the twenties, Americans regarded most international economic matters, including overseas investments, as beyond the purview of governments. Even monetary management was the concern of central banks, not governments, and gold-standard rules left little for central banks to manage. After the defaults, except for direct investments in resource-oriented private enterprises such as oil exploration, long-term capital scarcely flowed across national boundaries at all. Thus, to the extent that post-war reconstruction and longer run development required private, as distinct from government (e.g. Lend-Lease) assistance, private investors would, it seemed to Harry White, require government guarantees against defaults. Furthermore, if the world were to be improved by long-term private overseas investing, governments had to do what they could to see to it that borrowed funds were wisely used. This was the essence of the World Bank as Harry White saw it.

With not inconsiderable foresight, White wrote early in 1942,

> Once the combined operations of the Fund and the Bank serve to restore confidence in the continued stability of exchanges, and in the freedom from restrictions on withdrawal of profits, private capital will probably flow in large volume to areas in need of capital. At the beginning these foreign investments will take the form more likely of branch plants, complete ownership of mines, factories and plantations. With the restoration of confidence they will assume more and more the form of loans to governments, to municipalities and finally to foreign corporations. It is to free the tremendous accumulations -- past and future -- of private

> capital to seek profitable employment in countries that sadly lack capital that much of the activity of the Bank should be directed. To do so the Bank must pioneer with loans private capital is as yet justly too wary to undertake, while at the same time both Fund and Bank must seek to develop those conditions in which trade and productive capital movements can be expected to prosper.[25]

VII

White's Fund would have been managed by a small operating committee assisted by a technical staff. It would have been a powerful committee since it would have had to approve all exchange rate changes and the purchase of needed currencies in excess of some minimum by deficit countries. The Bank would have been directed by a president selected by the Board of Directors. The president and his staff would receive loan applications, investigate the probable productivity of projects, and supervise approved loan expenditures rather along the lines followed by the United States Export-Import Bank. In general, however, the Bank would have interfered little with private overseas investment.

White seems to have thought of the Bank rather as a transition organization which could finance post-Lend-Lease reconstruction and long-run development until private capital was able to do the job.[26] He stressed the proposition that the Bank should guarantee private overseas investments against default rather more than that it should make direct loans out of paid-in subscriptions. Indeed, it was White's emphasis on

25. See "Suggested Plan for a United and Associated Nations Stabilization Fund and a Bank for Reconstruction and Development of the United and associated Nations," reprinted in Oliver, pp. 298-299.

26. John J. McCloy, the Banks' second president, thought that a successful World Bank would work itself out of a job in a decade or so.

guarantees that induced the British at Bretton Woods to support the Bank plan with enthusiasm. Keynes saw no point in an arrangement whereby borrowing governments would make scarce capital available to a bank only to borrow back their own funds, but he was persuaded that the greater portion (four fifths as it turned out) of each subscription could be held in reserve, pledged but not called unless needed to compensate for defaults.[27] In this way, the Bank could be truly international without requiring large payments by borrowing governments.

White's emphasis on private capital implied that private market assessments of risks would substantially determine the direction and magnitude of international loans, though the staff of the Bank might occasionally guarantee a private loan to finance a worthwhile project in a not-very-creditworthy country which private bankers might otherwise overlook. Of the two organizations, however, the Fund would probably have been the more active in the sense of restricting access to its resources by governments whose economies were poorly managed.

For their part, as an alternative, the British proposed a single international financial organization which would have been quite passive in its dealings with member governments and would, in a sense, have required no financial contributions at all. The proposed organization was the International Clearing Union drafted by Lord Keynes in the summer of 1941 after his initial Lend-Lease discussions in Washington.

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27. To date, there have been no defaults on direct Bank, or Bank guaranteed, loans.

Making use of the overdraft principle, more common in the United Kingdom than in the United States in 1941, Keynes proposed that member central banks of a Clearing Union be permitted, in effect, to purchase foreign currencies needed to finance balance-of-payments deficits with bookkeeping claims against the Clearing Union. A deficit central bank would run up a debit balance with the Clearing Union; a surplus central bank, a credit balance. Each national central bank would be assigned a quota determined by the volume of its foreign trade,[28] the major purpose of which would be to establish a maximum debit balance for each central bank.

Quotas in the Clearing Union would have been like subscriptions in White's Stabilization Fund or national stocks of gold in an international gold standard system, the major difference being that quotas would be costless to create and would require no contributions except in the sense that balance-of-payments surplus countries would contribute the real goods and services exported in exchange for claims having no value in and of themselves. (So it is also, of course, with paper money in a national monetary system.)

The American negotiators quickly perceived that if all members but one ran up maximum debit balances, the credit balance of the remaining member would be huge (over $30 billion if all nations were

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28. Keynes proposed that each quota equal 75 percent of the sum of each country's average annual exports and imports for the three pre-war years. This formula would have made the British quota (and voting power) larger than the American.

members and $48 billion was the average annual volume of world trade from 1936 to 1938), and they suspected that the United States might be the only balance-of-payments surplus (credit balance) nation in the immediate post-war years. The maximum possible obligation of the United States under Keynes's Clearing Union plan would have been $31 billion, while the maximum possible obligation of the United States under White's Stabilization Fund exclusive of his International Bank would have been $3 billion, a contrast sufficiently great to discredit the Clearing Union plan in the United States.[29] An essential difference between the Fund and the Clearing Union was that borrowers could only buy currencies from the Fund if they had actually been paid into the Fund by other members or if the Fund had purchased them with gold, whereas borrowers could, in effect, have purchased currencies from the Clearing Union with bookkeeping entries.

Keynes and his colleagues argued that an excessive balance-of-payments surplus is no less disequilibrating than a balance-of-payments deficit. For this reason, surplus and deficit countries alike should be charged interest on their credit and debit balances with the Clearing Union. Surplus (creditor) countries can arrange not to have a surplus balance: they can import more or export less (by appreciating their currencies, by raising wages, and therefore,

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29. American bankers also protested that deficit (borrowing) members of the Clearing Union would control a majority of the votes. Voting rights in the Clearing Union, like those in White's Stabilization Fund, would have been based on the size of the quotas, and, during the post-war period, most nations would, it was supposed, be borrowers.

prices, by expanding income or by lowering import barriers); or they can extend loans to importing countries apart from the Clearing Union system.

Keynes denied that it was his intention "to make the United States the milch cow of the world . . ." "In fact," he argued:

> the best hope for the lasting success of the plan is the precise contrary. The plan does not require the United States or any other country, to put up a single dollar which they themselves choose or prefer to employ in any other way whatever. The essence of it is that if a country has a balance in its favor which it does not choose to use in buying goods or services or making overseas investments, this balance shall remain available to the Union -- not permanently but only for just so long as the country owning it chooses to leave it unemployed. That is not a burden on the creditor country. It is an extra facility to it, for it allows it to carry on its trade with the rest of the world unimpeded, whenever a time lag between earning and spending happens to suit its own convenience.[30]

But the Americans remained skeptical. They believed that Keynes' suggested quotas were unnecessarily large if currency stabilization <u>in the post-reconstruction period</u> were really the objective. They felt that too much of the burden of balance-of-payments adjustment was being placed on the surplus nation or nations. They were specifically convinced that, if adopted, the Clearing Union would make it possible for nations to live beyond their means at the expense of the United States. Besides, <u>they preferred separate organizations</u> to deal with temporary balance of payments problems, on the one hand, and longer-run reconstruction and development, on the other.

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30. See Keynes speech before the House of Lords, May 18, 1943, in <u>Parliamentary Debates on an International Clearing Union</u>. British Information Services (July, 1943), p. 77.

Somewhat ironically, neither White nor Keynes sought to distinguish clearly between the immediate post-war reconstruction period and the more normal post-reconstruction period. As Sir Roy Harrod later observed, Keynes "was anxious that big post-war reconstruction burdens should be thrown elsewhere, not into the permanent institutions,"[31] but, out of deference to the United States, Keynes did not discuss the reconstruction problem per se. For his part, White denied that there is ever a "normal" period.[32]

Also somewhat ironically, many Americans criticized Keynes' Clearing Union plan in the 1940s on the ground that deficit nations would have had too easy an access to "automatic loans" from surplus countries only to argue precisely the opposite in the 1960s when, as a deficit nation, the United States sought to provide the International Monetary Fund with authority to create the Special Drawing Rights which are similar to the overdraft quotas in Keynes Clearing Union proposal.

VIII

In the end, at Bretton Woods, the Americans largely had their way. Keynes had begun the Lend-Lease negotiations protesting that the United Kingdom would have to settle its trade accounts bilaterally with its natural trading partners for some time after the war, for its international reserves were depleted. He even doubted that a huge private dollar loan would help, because he could not forsee a time when

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31. Personal correspondence, September 13, 1953. See also Harrod, p. 533.

32. See Oliver, p. 118, note 40.

the United Kingdom could earn the dollars to repay such a loan.[33] Only gradually were Keynes and the British won over to the American conception of a free-trading, multilaterally clearing, free-market oriented world. The British remembered the Smoot-Hawley Tariff and the American experiment with dollar devaluation as well as the over-valued pound after 1925 and the flight from sterling in 1931, but they came to hope that international reserves would be adequately expanded and redistributed after the war so as to permit multilateral clearing.

Keynes himself came to be excited about the potential of the International Bank for Reconstruction and Development. Through it, Keynes believed, nations with inadequate reserves might obtain the convertible currencies -- as good as gold -- needed to pay for imports essential to reconstruction or growth. So he bowed to the superior power of the American experts, and, after Bretton Woods, vigorously defended the Articles of Agreement of the Bank and the Fund before a skeptical British Parliament.

Throughout the negotiations, the British remained adamant on three points:

1. The world must not return to an international gold standard or any other exchange-rate system which might require a national economy to deflate in order to protect its international reserves.

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33. See Van Dormael, p. 121.

2. Each member nation must have access to substantial Fund resources at its own discretion.
3. Each member government must retain the final authority to manage its economic affairs, including to determine the value of its currency in foreign exchange markets, regardless of the representations of an international monetary organization.

The Americans agreed that a fundamental balance-of-payments deficit should be cured by currency devaluation rather than deflation with depression. What the Americans opposed was a currency devaluation which gave a competitive advantage to the devaluing country, thereby forcing depression or devaluation on other countries. Of course, both sides were thinking in the context of the world-wide depression, and this affected the arguments. In the world of the 1950s and 60s, currency devaluation was needed not to stimulate exports so as to increase output and employment but rather to induce a better import-export balance in a high-employment country suffering from inflation. In too many instances, moreover, import surplus countries avoided for too long both devaluation and the domestic measures needed to curb inflation. In short, the Anglo-American discussions of the early forties were inconclusive and somewhat out of date.

Eventually, the Americans agreed that creditor (surplus) nations do have some responsibility for world-wide balance-of-payments equilibrium, particularly in a depression. In the Fund, therefore, if the currency of a given country is so much purchased (borrowed) as to become "scarce," other countries are permitted to discriminate

against the exports of that country. In the post-war years, moreover, member governments were permitted unilaterally to devalue their currencies by up to 10 percent.

These American concessions went a long way toward satisfying the British. During the post-war transition period, the United States dollar was indeed "scarce," and other members of the Monetary Fund were obliged to "ration" their imports of American goods and services. In the longer run, however, the need for large and frequent exchange-rate changes became so acute that par values ceased to have the meaning they had had in gold standard days. Indeed, after February, 1973, fluctuating rates became the normal condition. It was, in a way, a final triumph of Keynes over White with the Americans (including Milton Friedman) in the 1970s defending earlier Keynesian positions about exchange-rate changes.

Until the oil crisis of 1973-74, the amount of foreign exchange any Fund member could purchase was circumscribed by the size of its quota. It could purchase available foreign exchange equal in value to 25 percent of its quota (matching its 25 percent gold payment) at its own discretion. Beyond that, additional purchases (up to an additional 100 percent of its quota) required Fund approval. This gave members smaller automatic drawing rights than they would have had in Keynes' proposed Clearing Union or, for that matter, in White's proposed (1942) Stabilization Fund. But the final accord provided for total quotas of $10 billion ($8.8 billion for the nations represented at Bretton Woods) rather than the $5 billion initially proposed by

White, and this went some distance toward providing adequate discretionary borrowing rights for member governments. More recently, moreover, a variety of special facilities have been added to the Fund permitting some members to borrow considerably more than specified in the original Articles of Agreement.

To the end at Bretton Woods, the Americans insisted that the Fund and the Bank should have authority in some matters which, in a sense, usurped national sovereignty. Member governments can always withdraw from, or ignore, the Fund and the Bank, but members who actively participate must recognize that their economies are subject to some Fund and Bank authority. The more a member borrows from the Fund, the more the Fund must be satisfied that that government is taking the necessary steps to deal with its balance-of-payments disequilibrium. Members who borrow from the Bank must satisfy Bank requirements that the funds are usefully used. Increasingly, beginning in the late 1950s, the staffs of the Fund and the Bank concerned themselves deeply with the internal economic affairs of their members, not infrequently in ways which induced headlines in the international press. These intrusions would have surprised the American delegation to Bretton Woods and would probably have infuriated the British, who regarded national economic sovereignty as absolute, whatever might be agreed about plans for a Fund and a Bank.

In his biography of John Maynard Keynes, Sir Roy Harrod has commented:

> The Americans are in the habit of praising private initiative and inveighing against paternalistic socialism. In the minds of many Americans, who do not specialize in these subjects, Keynes has been thought to be a sort of high priest of the paternalism they so much dislike. Yet, when the Americans turn their eyes away from their own rights under the Constitution toward the international sphere, it is they who have recently tended to be the chief advocates of paternalism. It was Keynes who had to fight the battle of liberalism against the voracious appetite of the Americans for paternalistic interference. Keynes thought of the international institutions as setting up a framework within which individual initiative could flourish; they were to settle certain broad principles of action; the Fund in particular, would establish certain drawing rights, but only interfere in their exercise on most exceptional occasions. The Americans wanted to give meticulous scrutiny to each individual transaction. In all this long-drawn-out conflict it appears that Keynes was fighting for the philosophy of freedom against the philosophy of regimentation.[34]

This is, of course, not the only interpretation of British-America differences. Keynes was not so much concerned with the economic freedom of individuals and private business units as he was with the freedom of a government to act while paying little attention to the economic actions of, or the consequences of its own actions on, other economies. The Americans were primarily concerned with codifying the rules of inter-government behavior in international monetary and investment matters so that private enterprise might be guaranteed freedom of action unfettered by capricious acts of nationalistic governments.

IX

Harry White's proposals for a Fund and a Bank went through many drafts and many interdepartmental discussions and were the subject of

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34. Harrod, pp. 570-7.

many conversations with British experts before they emerged, not seriously modified, from the Bretton Woods conference. Throughout, White was prepared to modify words and to reconsider policies and procedures. He was particularly concerned about Congress. Would Congress accept new international organizations possessing some of the attributes ot national sovereignty? Through it all, however, White remained adamant on two points: voting power must be related to the contributions of the member governments, and the Fund and the Bank must be truly international.

British and American experts were always agreed that each government's voting power should be more or less proportional to its share of the total quotas in the Fund or subscriptions in the Bank. In the case of the Bank, it was apparent that the economically larger countries would be suppliers of loanable funds and would have to be satisfied with the operations of the Bank if the supply were not to dry up. One might hope that creditors would judge the Bank on the basis of broad economic rather than narrow political criteria, but whether investors be people or governments, return on investment will influence the willingness to invest. When governments are requested to contribute to larger quotas in the Fund or subscriptions to the Bank or to replenish the Bank affiliated International Development Association, political considerations may influence national decisions. But when the Bank arranges to marshall private, loanable funds, efficiency, productivity, and credit worthiness are not unimportant.

From time to time, critics of the Bretton Woods institutions

seem to imply that the world would be improved if the industrial nations provided a pool of funds which could be assigned in some manner to low-income countries and used by governments of those countries as they saw fit. To be sure, this was the model for European use of American Marshall Plan aid, but the Marshall Plan had clear, limited objectives, and the recipients of the aid had the internal requisites for recovery; they lacked only the means to finance imports while their export capacity was restored. In any event, it is quite impossible that the American Congress would have approved in 1944 or 1945 or, for that matter, 1984 an open ended commitment to finance a development bank or contribute to a stabilization fund in which the votes of the borrowers exceeded the votes of the lenders.

White opposed the opposite extreme. The question arose, for example, as to the point of having nations pay their currencies into a Bank (or a Fund) <u>or vote at all</u> if there is virtually no possibility that other nations would ever want to borrow their currencies. In the case of currency stabilization, why not limit the pool of currencies to the few "key currencies" to which other currencies are tied? In the case of development loans, why not let the American Export-Import Bank do the job?

To arguments such as these, White replied that nations will not feel responsible to organizations to which they contribute nothing. In testimony before the Foreign Affairs Committee of the House ot Representatives in May, 1944, White argued:

> We need agreement among the United and Associated Nations to define the parities of their currencies in terms of gold, to keep these

parities unless changed after consultation, to avoid competitive currency depreciation, and to refrain from restrictive and discriminatory exchange practices that hamper the growth of world trade. To make such arrangements effective, they should be through an international institution embracing all interested countries. To provide adequate resources and reduce the risk to any one country, funds for helping to maintain stable and orderly exchange rates should be subscribed by all countries and should be available to member countries prepared to agree to these principles of international monetary cooperation.

The problem of post-war international investment cannot be solved merely by the provision of funds by this Government. The revival of the free flow of private capital for international investment is an international problem. All countries share in the benefits of increased production and increased trade that result from productive investment. It is only proper that all countries should share in the risks.

The essential aspect of the post-war problem of international investment is to assure an adequate flow of private capital for productive purposes. This can be done only by aiding and encouraging private investors to provide capital through the usual investment channels. To do this, private investors must have assurance that the funds they provide will be used for productive purposes, that the balance of payments of the countries in which they invest will permit the servicing of their investments, and that their investments will be free of the risks of depreciating currencies and exchange restriction.

An international agency with resources contributed by all interested countries prepared to guarantee loans for productive purposes can give private investors the assurance they need. Where the funds of this Government are to be used for international loans on a bilateral basis, this can continue to be done through the Export-Import Bank.[35]

White might have added that an international organization can intrude upon national sovereignty with greater ease and, probably, to

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35. See 'Reconstruction Fund in Joint Account with Foreign Governments for Rehabilitation, Stabilization of Currencies, and Reconstruction,' Hearings Before the Committee on Foreign Affairs, House of Representatives Seventy-Eighth Congress, Second Session on H. J. Res. 226 (Washington: United States Government Printing Office, 1944), p. 11. Hearings were conducted on April 25, 26, 27, 28, and May 16, 17, 1944.

better effect than can a national instrumentality. Since it is an international body, the World Bank can send missions to borrowing nations to investigate loan applications, and it may be able to attach specifications and restrictions to its loans which it would be difficult for a national government to attach without inviting charges of imperialism. As contrasted with strictly private international investing, the World Bank may be able to hasten worldwide economic development by extending loans on more favorable terms and by being able to overcome the imperfections of the market. By more thoroughly investigating loans before they are made, the Bank may also increase the productivity of the loans. It may even be able to reduce the risks of private lending.

Since it is an international body, the International Monetary Fund can impose economic conditions on borrowing governments and on lending institutions which are more rigorous than any likely to be accepted if proclaimed by national stabilization funds, treasuries, or central banks. Indeed, the evolution of the gathering of information and the insistence on conditions as prerequisites of Bank or Fund loans has been the subject of much discussion and will be, it can be expected, the subject of much more.

Beyond all this, White was fully committed, as were many Americans in 1944, to a world in which nation states were subject under some conditions to international authority.

X

In January, 1942, at the request of Harry White, during a conference of the American States in Rio de Janeiro, Under Secretary of State Sumner Welles mentioned White's plan for currency stabilization, and the conference passed a resolution recommending that the Ministers of Finance of the Governments of the American Republics participate in a special conference to consider the establishment of an international stabilization fund. White was eager to have a conference that very year, but discussions moved slowly within an interdepartmental committee of the United States government. The conversations between White and Keynes, which began in the fall of 1942, continued until the Bretton Woods conference convened on July 1, 1944. White's eagerness for early international discussions was thwarted, though his dedication to a fully international approach remained. In his first meeting with White, Keynes urged that the U.S. and the U.K. work out a joint plan before inviting other nations to participate, but White objected that "this would create the suspicion of an Anglo-Saxon financial 'gang up.'"[36] Thus, while detailed negotiations continued between Britain and the United States, the British kept the Dominions and some Europeans informed, the Americans dealt with the Latin Americans and the Russians, while the Canadians offered a currency stabilization plan of their own -- a sort of compromise between Keynes and White.

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36. Penrose, p. 48.

Negotiations with the Russians were general. They were conducted through Foreign Minister Vyacheslav Molotov (who had succeeded the friendlier Maxim Litvinov in May, 1939, shortly before the Russo-German non-aggression pact, which cleared the way for the Nazis to attack Poland). A starting point was discussion of reparations and international cooperation in the repair of damage to the U. S. S. R.[37] Molotov seemed receptive to suggestions of an international lending agency as well as currency stabilization, though he particularly wanted international recognition of the Soviet Union as one of the Big Three (Big Four, including China, if the Americans insisted.) Indeed, the Soviets probably participated at Bretton Woods more for political than for economic reasons and lost interest when American reconstruction lending became unlikely and the voting formula ranked the Soviets below the British and the Americans.[38]

During the spring of 1944, shortly before Bretton Woods, Harry White met with representatives of various nations to discuss his Bank proposal, at which time the Soviets sought a commitment that the Bank would finance Soviet reconstruction on favorable terms. They also sought to reduce the gold payments required of countries damaged by

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37. See, for example, the conference between Secretary of State, Cordell Hull, Foreign Secretary Anthony Eden and Foreign Minister V. M. Molotov in Moscow, October 29, 1943: Hull, p. 1303.

38. At Bretton Woods, M. S. Stepanov sought a large quota in the Fund and even said that Russia would be glad to present data (on national income, trade and gold reserves) which would justify such a quota, but his offer was never put to the test. See Van Dormael, p. 195.

enemy occupation, to prohibit the inspection of state-trading nations, and to guarantee that the U.S., the U.K., the U.S.S.R., and China should each have at least 10 percent of the total voting power.[39]

Similar representations were made by the Soviet delegation at Bretton Woods, where it was agreed that nations devastated by war might withhold for five years 25 percent of their quota payments to the Fund. At Bretton Woods, the Soviet subscription to the bank was increased as the Soviets requested. It was also agreed that only 2 percent of each Bank subscription need be paid in gold or gold-convertible currencies. (In White's 1942 bank draft, 25 percent of each subscription was to be paid in gold.) Thus, the Soviets received the concessions they sought but chose not to join anyway. In March, 1943, Secretary of State Cordell Hull

> . . . asked [British Foreign Secretary Anthony] Eden whether he thought Stalin had any other choice than these two alternatives: one, isolation after lopping off certain territory along Russia's boundaries, accompanied by the maintenance of heavy armaments; two, become part of the world and meet all Russia's responsibilities under a sane, practical policy of international cooperation. Eden said he knew of no other choice.[40]

Many Americans, including Harry White, whose parents had immigrated to the United States from Russia, hoped -- in vain as it turned out -- for the second of these alternatives, but Stalin chose the first, and Marxists the world over have criticized the World Bank and the Monetary

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39. See the White Papers.

40. Hull, p. 1247.

Fund ever since as capitalist institutions which discriminate against socialist governments and remain uninterested in programs designed genuinely to benefit the poor.

After Bretton Woods, even the British were difficult. Keynes was annoyed that the headquarters would be in the United States rather than the United Kingdom. (At a subsequent meeting, he was additionally annoyed that the headquarters would be in Washington, D.C. rather than New York.) He was also annoyed to discover after the conference that "the par value of each currency of each member share [would] be expressed in terms of gold . . . or . . . the United States dollar of the weight and fineness in effect on July 1, 1944." Keynes had fought for an abstract unit of account such as a "bancor" or a "unitas" or, though the name was not then suggested, a "Special Drawing Right." (As it turned out, this American "victory" at Bretton Woods made it more difficult than otherwise in 1971 to devalue the over-valued dollar.)

It was the British Parliament which objected most strongly to Bretton Woods, however, and, in retrospect, it appears probable that the British would have rejected the Fund and the Bank altogether had it not been for the $3.75 billion loan negotiated by Keynes and agreed to in Washington on December 6, 1945, just three weeks before the expiration date by which 65 percent of the quotas in the Fund had to be subscribed if the Fund and the Bank were to come into being.[41]

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41. See Oliver, p. 221; and Van Dormael, pp. 266-71.

In late 1944, the Federation of British Industries recommended that Britain postpone action on the Bretton Woods agreements. The London Chamber of Commerce was critical. There was much conservative objection to any British commitment to non-discriminatory trade and to any British retreat from a sovereign right of each nation to establish its own foreign- exchange rate. There was general animosity to any international monetary system which resembled the gold standard the British had tried unsuccessfully to preserve in the years before 1931, an animosity no less pronounced in the Labor Party which won the elections of July, 1945.

The Economist argued that it was "obvious nonsense" to expect any country to commit itself in 1945 to a par value for its currency within the limits of 10 percent.[42] Sir Robert Boothby referred to acceptance of Bretton Woods as "our economic Munich."[43] Nevertheless, with their backs to the economic wall, offered a dollar loan, which they had expected to be a gift, of $3.75 billion, with Winston Churchill urging conservatives to abstain and Prime Minister Atlee enforcing party discipline, the House of Commons approved the loan and the Bretton Woods agreements on December 14 after just two days of restricted debate. Reluctantly, with an American loan, the British accepted what the Russians, without a loan, rejected.

The United States was the first nation to ratify Bretton Woods. Indeed, there was no point in prior ratification by another nation:

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42. The Economist, July 21, 1945. Cited in Van Dormael, p. 271.

43. The New York Times, December 13, 1945.

without American participation, the Fund and Bank could not have begun operations: most of the unrestricted working capital came from the United States, the United States had the largest bloc of votes and was the principal sponsor. In subsequent years, moreover, increases in Fund quotas and Bank subscriptions as well as replenishments of the International Development Association, the soft loan agency of the World Bank Group, could occur only with action by the United States.

The Congress of the United States passed the Bretton Woods Agreements Act in July, and President Truman signed it into law on August 4, 1945. There was significant American opposition, however, and the support of the United States for its own institutional children, lukewarm after Bretton Woods, has become almost cold in recent years as member governments of the Fund and the Bank have criticized the tendency for the "Imperious [American] Economy" to behave with little regard for other economies.[44]

Some Americans have always felt that the United States government should control the dollars made available to the Fund and the Bank. For this reason, in 1945, opposition to the Fund was intense. The United States could control the Bank, it was supposed, because the Bank could lend few dollars without the assistance (and acquiescence) of American banks who market Bank, or Bank-guaranteed, bonds, and the government of the United States

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44. See David Calleo, The Imperious Economy (Cambridge, Mass.: Harvard University Press, 1983).

could withhold blanket permission for the Bank to lend any dollars at all. But the Fund was different. So the question was asked: Why not finance currency stabilization as well as post-war reconstruction for friendly nations through bilateral Export-Import Bank loans or ad hoc Treasury loans like that to Britain?

The best answer was the One-World answer -- that all nations should participate in decisions affecting the world economy. There was the powerful additional argument that the agreements accepted by forty-four nations could probably not be negotiated again. As Sir Dennis put the matter in 1943:

> Knowing what we know of the centrifugal focus at work among the nations of the world, of the ease with which wills tire and good interactions fail, can we doubt that in this, as in the political field, it would be wise to lay the foundations while imaginations are active and hopes are high.[45]

The opposition of nationalistic American critics was strong. President Roosevelt had hoped for congressional acceptance of Bretton Woods prior to the San Francisco United Nations Conference in April, 1945, but that was not to be, and the fledging Truman Administration was obliged to lobby hard in July to refute the spirited arguments of Senator Robert A. Taft. Had the Bretton Woods bill been introduced into the Eightieth Congress elected in 1946, it might well have met the same fate as the International Trade Organization.

XI

The Fund and the Bank that operate in 1984 resemble, but are

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45. Dennis H. Robertson, "The Post-War Monetary Plans," Economic Journal vol LIII (December, 1943), p. 357.

substantially different from, the organizations conceived at Bretton Woods. Of the two, the Fund is the more different, for it was virtually turned on its head in the 1970s when, led by the United States, the world abandoned an international system of fixed-but-adjustable exchange rates.

In the late 1930s, many economists supposed that the earlier decrease in world trade had been due in part to undue fluctuations of exchange rates. The fixed rates of the pre-1914 gold-standard days were generally admired. At the same time, it was recognized that wrong exchange rates could produce balance-of-payments disequilibrium and pressure for domestic contraction in balance-of-payments deficit nations. The British attempt in the 1920s to deflate so as to justify a pre-1914 price of gold was regarded as particularly unwise. As Keynes put the matter in a speech before the House of Lords on May 23, 1944:

> We are determined that in the future, the external value of Sterling shall conform to its internal value as set by our own domestic policies, and not the other way round. Secondly, we intend to retain control of our domestic rate of interest, so that we can keep it as low as suits our purposes, without interferences from the ebb and flow of international capital movements or flights or hot money. Thirdly, whilst we intend to prevent inflation at home, we will not accept deflation at the dictate of influences from outside.[46]

By the 1950s, the logic of Keynes' position suggested to some that exchange rates between major trading areas should be allowed to

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46. For the full text of Keynes' speech, see Seymour E. Harris (ed.) The New Economics (New York: Alfred A. Knopf, 1948), pp. 369-79.

fluctuate without any government intervention so as to produce instantaneous and perpetual balance of payments equilibrium regardless of the internal fiscal and monetary policies of respective governments. Advocates of fixed rates argued, on the other hand, that unstable exchange rates would induce a reduction of trade and an undesirable movement of international capital into those major countries where domestic economic stability was expected. The argument continues to this day. In theory, of course, rigidly fixed exchange rates are consistent with balance-of-payments equilibrium only if domestic prices and outputs in the constituent economies are reasonably stable and are expected to remain so. By the same token, it has been argued, stable domestic prices and output in the constituent economies of the international system should produce stable exchange rates even in the absence of intervention by governments. Unfortunately, world conditions since 1973 have not permitted a test of the latter proposition.

White and Keynes agreed at Bretton Woods that, with the assistance of the International Monetary Fund, governments would intervene in exchange markets to prevent exchange-rate fluctuations due to temporary balance of payments disequilibrium, while fundamental disequilibrium would be dealt with by exchange-rate changes. But no one defined "fundamental disequilibrium," and no one specified a fool-proof procedure for identifying correct new exchange rates or a method for guaranteeing that destabilizing forces would not continue after the

change. Thus, from 1949 through 1973, "fundamental disequilibrium," however defined, occurred again and again only to be "cured" inadequately by changes in exchange rates. When a fundamental disequilibrium in the payments of the United States became apparent in 1971 and the United States was unwilling or unable to adjust its internal economy to solve the problem, the system had to be redesigned.

In the period of post-war reconstruction, most governments found it necessary to restrict the use of their own national currencies in international exchange, and in such a world it made little sense to talk of "temporary" or "short run" balance of payments disequilibria. In such a world, exchange-rate stability was achieved by exchange controls -- the very practice Harry White had sought to outlaw -- rather than by the measured, though marginal, intervention of stabilization funds in exchange markets. For at least a decade after the war, therefore, the International Monetary Fund seemed to have no purpose except to gather information about exchange restrictions.

Gradually, however, the dollar ceased to be scarce. Indeed, in the early 1960s, as American investors sent dollars into exchange markets to buy the local currencies needed to finance American investments abroad, the world began to experience a sort of dollar glut. More and more currencies became freely convertible, at least to pay for imports, and stable, equilibrium exchange rates mattered a great deal. In such a world, the International Monetary Fund also mattered a great deal.

Governments of many nations, large and small, rich and poor, came to

the Fund to borrow other currencies so as to finance balance-of-payments deficits everyone hoped would be temporary. Sometimes a deficit was temporary; in time, the borrowing government could easily buy back its own currency with the currency it had borrowed, spent, and then earned. Sometimes it was not so easy. Sometimes strong deflationary measures were needed at home to reduce the national demand for imports and, therefore, foreign exchange. Sometimes the payments deficit persisted until the nation's reserves were depleted and further borrowing from the Fund seemed inadvisable or impossible, in which case the alternatives were devaluation or exchange controls or both. Frequently devaluation seemed to come too late. Sometimes devaluation seemed to make a payments imbalance worse, at least in the short run, and if it worked in the longer run, it had to be accompanied by new deflation to reduce domestic demand.

Disequilibrium in the payments of the United States began to be apparent as early as 1958 when foreign central banks, which had been buying dollars not only to support the dollar but also to rebuild their international reserves, began to exercise their legal rights to buy gold from the United States at $35 an ounce. This was a sign that they regarded their dollar reserves as adequate for the time being and that the day might come when the dollar price of gold might rise. (Only the United States among the major powers was committed by law to trade gold for dollars at a fixed price. That had been the rationale at Bretton Woods for the proposition that one-fourth of each nation's quota should be paid in gold <u>or dollars</u> and why dollars were widely regarded as being "as good as gold," and vice versa. Indeed, for

twenty five years before 1959, the dollar had been generally regarded as better than gold in the sense that, at $35 an ounce, many foreign central banks generally preferred dollars.)

After 1958, the continuing payments deficits of the United States were financed by foreign central banks through purchases of dollars or United States Treasury gold. According to the discipline of the gold standard, the domestic economy of the United States was supposed to contract enough in nominal terms so that an export surplus would fully offset its net outflow of long-term capital. Instead, the economy expanded -- through real growth at first and then, after 1966, in part through price inflation. By March 15, 1968, when official Gold Pool sales of gold to private traders were suspended, there was ample evidence that the dollar was overvalued relative to gold. By 1971, when the United States developed a merchandise trade import surplus for the first time since 1871, there was a prime facie case that the dollar was overvalued relative to the trade-weighted average of other currencies.

In the absence of considerable domestic restraint, the Keynesian solution was a decrease in the external value of the dollar, but that solution was opposed throughout the 1960s for a number of reasons. It appeared difficult to decrease the value of the dollar relative to other currencies without raising the dollar price of gold, and the dollar and gold, tied together, were a central value about which the values of other currencies were supposed to fluctuate. Furthermore American authorities did not want to reward the Soviet Union and South Africa, major gold exporters, by raising the dollar price of gold. Foreign

exporters to the United States did not want the dollar price of their exports to rise. Many observers regarded the payments deficits of the United States as the best way to increase the international reserves of the world, in any event, and there were signs well into the 1960s that the world needed more liquidity to finance its rapidly growing trade.

In the end, on August 15, 1971, after unprecedented foreign central bank purchases of dollars, the Nixon Administration insisted that the external value of the dollar be allowed to decline. The Treasury Department suspended gold payments to foreign central banks, and the dollar floated downward to be stabilized again on December 17 (at the Smithsonian Institution in Washington) by international agreement at a new trade-weighted value relative to other currencies of about 8 percent below what it had been on August 14. The seemingly impossible had been accomplished: a modified fixed-but-adjustable exchange-rate system was still intact, and the dollar had been devalued.

The calm which ensued preceded a new storm, however. As the United States economy grew rapidly in 1972, the underlying price inflation, concealed briefly by wage and price controls, reappeared. So did the payments deficit. In March, 1973, the major trading nations of Europe and Japan withdrew support for the dollar, and the dollar began to float in response to market forces, as it continues to do today.[47]

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47. For a detailed account of these events, see Robert Solomon, The International Monetary System 1945-1982 (Revised Edition) (New York: Harper and Row, 1982). See also John S. Odell, U. S. Monetary Policy (Princeton, N.J.: Princeton University Press, 1982.) Significantly, the American gold window remained closed; the Treasury Department continued to refuse to exchange gold for dollars at any price even though the official dollar price of gold was set at $42.22 an ounce.

Needless to say, the consequences of these events for the International Monetary Fund were substantial. The Articles of Agreement had to be rewritten, the changes being collectively referred to as the Second Amendment which became formally effective on April 1, 1978. Instead of the proposition that "each member undertakes to collaborate with the Fund to promote exchange stability," a new Article IV committed members to "a stable system of exchange rates," which meant that member governments undertook to manage the internal affairs of their countries so as to promote stable though flexible exchange rates. (A member government might employ a par-value exchange-rate system so long as the par was not expressed in gold, and "other exchange arrangements of a member's choice were also acceptable.)[48]

A major effect of the Second Amendment has been to remove gold from the center of the system. Par values and quotas are now expressed in "Special Drawing Rights"[49] rather than in gold or a gold-convertible currency (e.g. the dollar). Indeed, the Fund has disposed of much of the gold which has been paid to it by its member governments. In place of the discipline of the gold standard, moreover, the Fund itself has sought from time to time to oversee the exchange-rate policies of its members, inducing governments to intervene in exchange markets when necessary to obtain "correct" exchange rates and to employ "correct" domestic economic

48. See Kenneth W. Dam, The Rules of the Game (Chicago: University of Chicago Press, 1982), p. 238.

49. A Special Drawing Right is the right of a government member of the Fund to exchange a book keeping claim against the Fund (an SDR) for currencies acquired by the fund as the result of the payment by government members of their quotas. Thus, a member might buy Japanese yen with SDRs and use the yen to finance a trade deficit. The value of

policies, though the Fund is bound to "respect the domestic social and political policies of members."

Events since 1973 have precluded "a stable system of exchange rates." As anyone who has followed the recent international discussions of Latin American debts or the United States balance of trade can testify, moreover, the concept of a correct exchange rate has become even more clouded than it was before 1973, and the role of the Monetary Fund has become even more controversial. It was once supposed that, given full employment without inflation in the various trading nations (internal balance), correct exchange rates would be consistent with a rough equality of visible and invisible exports and imports (external balance); if exports and imports were unequal, the balance would be financed by equilibrating movements of long-term capital.[50] It was even supposed that, in the longer run, long-term capital would flow from capital-rich or developed (low-interest-rate) to capital-poor or underdeveloped (high-interest-rate)

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an SDR is a weighted average of the values of German marks, French francs, British pounds, Japanese yen and U. S. Dollars. The SDR can decline in value relative to a basket of commodities, but is likely to fluctuate in value less than any one of is component currencies or, for that matter, gold.

SDR claims can be created by the Fund with the 85% majority approval of its members (rather like fiat money is created by a government) whenever the collective reserves of the member countries are judged to be inadequate. They were "invented" in 1967 by the First Amendment to the Articles of Agreement of the Fund primarily to provide a new international reserve asset or, as the French insisted, a new international line of credit, which would supplement gold, the supply of which could be increased only by mining (or price appreciation) and dollars whose supply held by foreign central banks could be increased only by official settlements United States balance-of-payments deficits. See Solomon, pp. 128-50; and Dam, pp. 151-169.

50. See, e.g., the classic work by J. E. Meade, The Balance of Payments (London: Oxford University Press, 1951).

countries. A sort of natural order would operate to distribute properly the production and the moveable resources of the world, and the Law of Comparative Advantage would insure that each region would produce that array of goods which would provide for it the greatest possible gain from its trade with other regions.

In terms of this idealized model, exchange rates since 1973 have been neither stable nor correct. Indeed, since 1981, the dollar has shown that a currency can remain historically high in spite of an historically high United States current-account deficit; and capital can be attracted away from low-income to high-income regions more or less indefinitely. It is an Alice-in-Wonderland world. Given the instability of the price and output levels of the major world economies since 1973, it is not surprising that exchange rates have been far from stable, but the knowledge that exchange rates can fluctuate widely has added a sort of "bandwagon effect" which tends to produce exaggerated fluctuations. Expectations of instability may also have intensified the search by international investors for a long-run relatively stable international asset (e.g., the dollar) thereby inducing exchange rates which lead to current account imbalances and invite distortions of comparative advantage.[51].

In such a world, the role of the International Monetary Fund

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51. For a summary of the growing literature on the factors which may influence exchange rates in a floating rate regime, see John Williamson, The Open Economy and the World Economy (New York: Basic Books, Inc., 1982), pp. 106-245. For a discussion of the effect of exchange rates on the structure of trade, see International Monetary Fund, Exchange Rate Volatility and World Trade, Occasional Paper 28, July 1984.

can hardly be the same as it was. There is no longer stored in the psyche of the Fund the concept, however vague, of balance-of-payments equilibrium against which temporary imbalances can be compared and, if necessary, offset by Fund financing. The Fund has largely become a sort of crisis-management lending institution of use largely to developing countries suddenly unable to finance imports at accustomed levels.

A payments crisis may be due to a sudden decrease in the world price, or the quantity, of a nation's major export commodity, a sudden increase in the price of a major import commodity (e.g. oil), a sudden reduction in the international flow of funds needed to finance imports (as in the current debt settlement crisis), or a sudden increase in the costs of borrowing. It may be all four. In such a crisis, an international organization may be of assistance not only in providing accommodating finance itself but also in encouraging the provision of accommodating finance by member governments and private lending institutions.[52] The staff of the Fund may also work with a beleagered government to suggest domestic policies which may alleviate the crisis over time, and the beleagered government may find it easier to accept these suggestions precisely because they come from an international source.

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52. In order to be of greater assistance in managing financial crises, the Fund has created a number of special funds which enable governments to borrow more than they could under the original quota system. See "IMF Survey" The Economist, September 26, 1981, after p. 54. See also IMF Survey, (The International Monetary Fund), November 1982; and recent International monetary Fund Annual Reports. Since the World Bank has inreased its lending to finance the payments deficits of some of its members, the division of authority between the Fund and the Bank has become less clear. See, for example, "The Bretton Woods Twins," The Economist, 15-21 September, 1984, pp. 17-18.

If the solution requires an increase of exports before the nation's imports can rise to earlier levels, the advice of the Fund may seem harsh: it is almost certain to involve currency devaluation and the reduction of domestic inflation, and the reduction of domestic inflation is almost certain to require a reduction in the government's fiscal deficit and the rate of increase of money wage rates. Unless wage contracts can be renegotiated downward quickly, moreover, anti-inflationary policy is likely to be accompanied in the short run by rising unemployment. But these are the consequences of shifts in an economy as it moves from a high to a lower level of inflation and from an import to an export surplus. In such a case, the Fund is not the cause but the expeditor of the solution of the problem.

Be that as it may, and even though the Fund operates somewhat differently today from the Fund agreed to at Bretton Woods, it performs a useful function. If the Fund did not exist, it would probably have to be invented, for short-term fluctuations in the flow of international payments are no less likely in a world of fluctuating, than of fixed, exchange rates, and international reserves are no less important in smoothing the transition. In gathering information and negotiating with creditors and debtors alike, moreover, the Fund performs a function which can best be performed by an international organization. And it is far from clear, in this era of international political confrontation, that international agreement on a wholly new short-term international

lending organization could be obtained even if a better one, in the view of some, were proposed.

XII

Like the Fund, the World Bank operates today in ways not intended at Bretton Woods. Harry White originally supposed that the World Bank would make loans to member governments by issuing notes which would be backed by the subscriptions of member governments and, therefore, in part by gold. The notes would have been convertible into national currencies as needed to help finance the import of borrowing (developing) countries. (This arrangement could be put into practice today if S. D. R's were issued by the Fund to the Bank and then loaned by the Bank to borrowing governments.) But the note issuing idea was quickly dropped.

At Bretton Woods, it was supposed that the Bank would make some loans directly from paid-in subscriptions, but that most of its loans would be of funds borrowed in the capital markets of its members, each member's subscription serving as collateral. For nearly forty years this was the Bank's primary mode of operation. During the early years the Bank sold its bonds in the financial markets of the United States and loaned the dollars it borrowed. In the early years, therefore, the success of the Bank depended heavily on the esteem in which it was held by New York investment bankers and, of course, on the unpaid subscription of the United States

government, the size of which provided a ceiling on the Bank's borrowing and, therefore, its lending capacity. More recently, the Bank has borrowed heavily in Japan, Switzerland, Germany and the OPEC nations where interest rates have tended to be lower than in the United States. By pooling its borrowed funds and using its own interest-free paid-in capital and earnings, the Bank is able to offer its borrowers long-term interest rates which are usually below three-month Euro-currency rates.

At Bretton Woods, it was also supposed that the Bank would assist the flow of capital to low-income countries by guaranteeing private loans. Indeed, this was the idea which won Keynes' support for the Bank. He saw no point in pretending that the war-devestated or the underdeveloped nations could make capital available to finance reconstruction or development, but he took it to be quite reasonable that all governments could join in making up the losses, if any, of private investors who had made loans for Bank approved projects.

This procedure was not used in the post-war world. Private investors were too suspicious; they would buy World Bank bonds more readily than foreign government bonds guaranteed by the Bank. After the oil crisis of 1973, private bank loans to the wealthiest developing countries became available without World Bank guarantees -- occasionally, it may be added, to finance projects which might not have met World Bank standards. Bank-guaranteed private loans to finance development may become more important in the future. Since 1974, in fact, the Bank has joined private banks and national export-

credit institutions in a considerable amount of co-financing.[53] Occasionally, the Bank has even sold a seasoned loan to private buyers thereby freeing funds for its own new loans.

In the 1950s, the absorptive capacity and the credit worthiness of prospective borrowing countries were so much in doubt that the Bank had trouble lending a few hundred million dollars a year. Today, in contrast, the World Bank Group lends $15 billion a year, and its officers indicate that it could usefully lend more if it had access to more loanable funds.[54]

The really important change in the Bank's approach to development finance came with the institution, in 1960, of the Bank's sister organization, the International Development Association, the staff and officers of which are the same as the Bank's but whose charter is different. IDA extends zero-interest-rate, 50-year loans to the governments of the lowest per-capita income countries (below $411 in 1981 dollars). It does so not because the projects financed are less productive than than Bank financed projects but because the borrowing countries' growth rates would be too low if repayment on anything like commercial terms were required. Since some of each

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53. See the World Bank, Annual Report, 1983, p. 18. See also "World Bank Survey," The Economist, September 4, 1982.

54. From 38 members in 1946, the Bank has grown to 144 members. Its authorized subscriptions have grown from $8.8 billion to $75 billion. Of the recent increases in total subscriptions, only 7.5 percent (in contrast to the original 20 percent) must be paid in. This has made possible an increase in the Bank's borrowing and lending capacity without a corresponding increase in payments by member governments. In addition, consideration is being given to permitting the bank to lend a total amount in excess of its total subscriptions.

new Bank loan is offset by payments of principal and interest on past loans, moreover, annual net IDA lending sometimes exceeds annual net Bank lending.

IDA turned the philosophy of the World Bank upside down. Before IDA, the Bank preferred to deal with the developing nations with the highest per-capita incomes -- the most able to pay. After IDA, the World Bank Group paid particular attention to the clients with the lowest per capita incomes -- the least able to pay. This was contrary to the intentions of the American and British treasury experts who drafted the Bank plan. They had supposed that market interest rates would guide the direction of the international flow of capital and that the Bank would encourage private capital by insuring that borrowed funds were wisely used.

The long-term international capital movements of the late 19th and early 20th centuries had helped to finance the development of most of North America and some parts of Latin America, Asia and Africa -- those parts where the prerequisites of growth were present and where, therefore, the rates of return on capital were high. That pattern of development was interrupted by World War I, resumed only partially in the 1920s, and halted altogether in the 1930s. As with the Fund, therefore, the Bank was intended to be an instrument through which an earlier epoch could be regained.

In its earliest days, the working Bank operated as a true bank in the sense that it waited for loan applications and expected the applying governments to justify their requests. The few loans that

were made financed low-risk energy and transportation projects in obviously creditworthy countries. Gradually, however, it became apparent that development in those parts of the world in which private capital had not been attracted required more active Bank participation in the development process. It required concessionary finance for the poorest countries and a whole new literature describing and analysing the development process. It was not enough merely to say that economic growth requires additions over time to the stockpile of capital.

From a passive bank, therefore, the World Bank has evolved into an active development organization which substitutes itself for the long-run capital market in much of the developing world. The staff of the Bank identifies potentially productive projects, including projects such as schools, housing and family planning which increase the stockpile of human, in contrast to physical, capital. The staff ranks potential projects and identifies their complimentarity and their balance-of-payments effects. It investigates its predictions after projects have been completed so as to refine the techniques of prediction. It even provides a school in which the bureaucrats of its member developing countries can learn about development. All of this would probably have surprised the drafters of the Bank's Articles of Agreement.

Like the Fund, the Bank has considerable influence over its member governments. The Bank has been known to withhold loans to governments whose fiscal or monetary policies seem to reduce that country's credit worthiness. It has refused to deal with

governments which do not negotiate with private lenders about defaults. On the other hand, it cannot oversee the implementation of each financed project in such detail as to preclude all graft. Thus, the Bank is sometimes criticized not only for interfering in the domestic affairs of its member states (e.g., by encouraging private rather than government enterprise[55]) but also for interfering too little (e.g., to insure that the needy benefit from bank loans[56]). Like the Fund, the Bank has its detractors, particularly Marxists, on the one hand, and extreme exponents of the Free Market, on the other; but, like the Fund, if the Bank did not exist it would probably have to be invented.

The Bank gathers an enormous amount of useful information about the economies of its clients. The professional literature about economic development is a great deal more sophisticated than it was before the Bank began actively to involve itself in development planning and assessment. While the roughly $30 billion in long-term claims of the Bank against the non OPEC less developed countries is a small fraction of the roughly $700 billion outstanding indebtedness of those countries, the Bank has played a disproportionately large role in developing the world.

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55. See Teresa Hayter, Aid as Imperialism (London: Penguin Books Ltd, 1971).

56. See Cheryl Payer, The World Bank, A Critical Analysis (New York: Monthly Review Press, 1982). For a more balanced view, see Robert L. Ayres, Banking on the Poor (Cambridge, Mass.: The MIT Press, 1983). See also Andrew M. Kamarck, "The World Bank and Development: A Personal Perspective," Finance and Development, December, 1984.

XIII

The one area in which the Bank was clearly inadequate was in the postwar reconstruction of war-devestated economies. This deficiency was ironic, since reconstruction was the first order of business for a bank whose full title is the International Bank for Reconstruction and Development. Indeed, at Bretton Woods, at the insistence of the Eastern European delegations (in opposition to the Latin American delegations), words were added to the first purpose of the Bank:

> To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, <u>including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peace time needs, and the encouragement of the development of productive facilities and resources in less developed countries.</u>[57]

The Bretton Woods Conference ended on July 22, 1944. Germany surrendered on May 8, 1945. A nuclear weapon was dropped on Nagasaki on August 9. The Bretton Woods Agreements were ratified by the requisite 65 percent of the weighted votes of the Bretton Woods signatory powers on December 14, and the Inaugural Meeting of the Fund and the Bank convened the following March 8. Two months later, the Executive Directors of the new international organizations began to meet in a new building in downtown Washington, D.C. located on H Street across from the old State Department building and

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57. See Oliver, p. 184. The words underlined were added at Bretton Woods.

originally intended for State Department use. But preparations for Bank lending were painfully slow.

On June 4, 1946, Eugene Meyer, publisher of the Washington Post, became the Bank's first president and the search for a staff began. On June 25, member governments were notified that 2 percent of their subscriptions would be due within sixty days and that an additional 3 percent would be due on November 25. By May 26, 1947, the full 20 percent of each member's subscription which could be called was paid in full. Of this, however, just slightly more than $700 million was in United States dollars authorized for direct use by the Bank. It was not until July 15, 1947, that an additional $250 million was obtained by the Bank through the sale of its first bonds.[58] By this time the need for a Marshall Plan was evident.

On March 5, 1946, at Fulton, Missouri, Winston Churchill warned: "From Stettin in the Baltic to Trieste in the Adriatic, an iron curtain has descended across the continent. Behind that line lie all the capitals of the ancient states of Central and Eastern Europe." Stalin had remained oblivious to the protests of American negotiators that he was violating his agreement at Yalta to

> . . . assist the people in any European liberated state . . . to form interim governmental authorities broadly representative of all democratic elements in the population and pledged to the earliest possible establishment through free elections of governments responsive to the will of the people . . . .[59]

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58. See Oliver, pp. 246-49.

59. For a critical discussion of the Yalta Conference, see W. W. Rostow, The United States in the World Arena (New York, Harper & Brothers, 1960), p. 109.

Indeed, Communist parties in France and Italy threatened to move the Iron Curtain westward.

When Secretary of State George Marshall returned on April 28, 1947, from a meeting in Moscow of the Council of Foreign Ministers, he asked George Kennan to set up a State Department Policy Planning Staff which quickly concluded that the rehabilitation of Western Europe, including the restoration of German output, was of urgent importance.[60] On June 5, at Harvard University, the Secretary of State formally proposed the Marshall Plan. Reconstruction lending by the World Bank would be too little and too late. As Bank President John J. McCloy would say, the Bank compared to the Marshall Plan was like a rowboat compared to the Queen Elizabeth.[61]

In 1947, the Bank did make four reconstruction loans: to France ($250 million), the Netherlands ($195 million), Denmark ($40 million), and Luxembourg ($12 million). By January, 1948, the Bank also had loan requests from Chile ($40 million), Poland ($600 million), Italy ($250 million), and Yugoslavia ($500 million). By then, however, the Organization for European Economic Cooperation was in the business of using Marshall Plan funds to assist in the recovery of Western Europe, and the Bank had decided that, due to "existing political

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60. Kennan, p. 222. See also Acheson, pp. 236-35.

61. Oliver, p. 239.

difficulties and uncertainties," loans to Eastern Europe could not be made.[62]

Could the Bank have financed European reconstruction? Judging from the events of 1945 through 1948, the answer would appear to be "No," and one may conclude that Harry White and his colleagues in the United States Treasury Department in 1944 were naive in supposing that it could. It is not impossible to understand their reasoning, however. They hoped that the Bank and the Fund could be established quickly and that the lending capacity of the Bank would be greater. They supposed that immediate postwar reconstruction and relief would be substantially financed by a continuation of wartime Lend Lease and by ad hoc United States government loans. They also assumed that the postwar world would be peaceful, that trade barriers would be relaxed, and that private capital would respond favorably to stable exchange rates and freely convertible currencies. It was an "impossible dream" only in the short run.

XIV

In the words of Professor Jacob Viner, the Americans who participated in planning for the post-World War II world were

> . . . trying to reverse the whole trend of policy and practice of the world at large in the field of international economic relations since 1914 and especially in the ill-fated years since 1929. [They were] attempting to do this, moreover, in the face of a skeptical world, undecided as to its objectives, and in particular lacking solid faith in the virtues of a pattern of international economic

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62. See Oliver, p. 245. See also Thomas G. Patterson, Soviet American Confrontation (Baltimore: The Johns Hopkins Press, 1973), pp. 130-36.

> collaboration which can be reconciled with difficulty, if at all, with the comprehensive national planning of domestic economies to which most of the governments [were] strongly committed.[63]

They sought to make trade barriers as moderate and nondiscriminatory as possible, to provide for international collaboration aimed at high level employment and stable exchange markets, and to encourage the flow of long-term capital from capital-rich to capital-poor areas. They desired the participation by all nations in international organizations which could provide the international macro-economic climate within which market forces could operate to promote the welfare of the planet. Seldom, if ever, had political economists had such an opportunity to shape the destiny of the world.

Out of the chaos of the 1930s came the International Monetary Fund, the World Bank, and the General Agreement on Tariffs and Trade. Out of the horror of World War II came the United Nations Organization and, later, the European Economic Community and the Organization for Economic Cooperation and Development.

Nor were the aspirations of the postwar planners denied. In spite of the Cold War, Korea and Viet Nam and the structural disequilibrium induced by the oil crises of 1973 and 1979, the real commodity output of the world has increased four fold since World War

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63. In Murray Shields (ed.,) International Financial Stabilization, A Symposium (New York: Irving Trust Company, 1944); reprinted in Jacob Viner, International Economics (Glencoe, Ill.: The Free Press, 1951), p. 133.

II; the real commodity trade of the world, six fold.[64] Even though the population of the world has more than doubled -- from approximately 2.2 billion in 1950 to 4.5 billion today, living standards have risen substantially on the average (not equally in all regions),[65] and the signs of political, cultural and economic integration abound.

Looking back at the United Nations Monetary and Financial Conference held forty years ago at Bretton Woods, one may be confused by conflicting emotions. Given the economic and financial problems confronting the world in 1984 and the current criticisms of the Fund and the Bank (either for being too prudent or too imprudent), one may discount Bretton Woods and advocate modified, if not altogether new, international monetary and financial institutions. Looking back on the post-World-War-II history of international monetary affairs, on the other hand, one may applaud the wisdom of the Bretton Woods negotiators as well as the abilities of the managers of the Fund and the Bank to adapt their organizations to the needs of their times.

Perhaps the most notable heritage of Bretton Woods is the international character of the Bretton Woods institutions. It is the international character of the Fund and the Bank, as well as their pocketbooks of loanable funds, which allows their officers to deal effectively with the governments of their member nation states. The

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64. See General Agreement on Tariffs and Trade, International Trade 1982/83 (Geneva, 1983), p. 203.

65. A population of 6 billion is projected for the end of the century. Living standards have increased the least in Black Africa, though even there the record is mixed.

One-World approach of the New Deal remains as the most indelible mark of that era.

Franklin Roosevelt died on April 12, 1945, and his global perspective was replaced in Washington by a commitment to an Atlantic Alliance as a bulwark against the Soviet Union. Under Harry Truman the foreign policy role of the Treasury Department rapidly diminished.[66] Almost as rapidly Soviet-American animosity grew. A week after Roosevelt's death, Averell Harriman, the American Ambassador in Moscow, warned Truman that the Soviets intended to extend their control over neighboring countries. Less than two years later, Will Clayton, the wartime Assistant Secretary of State, warned that "The countries under Communist pressure require economic assistance on a large scale if they are to maintain their territorial integrity and political independence."[67]

As the Big-Three wartime collaboration faded, suspicions of some individuals grew. On August 21, 1945, Elizabeth Bentley began to report to the Federal Bureau of Investigation about a spy ring which, she said, included Harry White. Shortly thereafter, White was placed under FBI surveillance. Though the evidence was insufficient in 1947 to warrant a Federal Grand Jury indictment, the FBI concluded that White gave United States Treasury Department documents to a group which included N. G.

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66. See Rees, op. cit., particularly pp. 315-22 and 350-426.

67. This summary of Clayton's unpublished memorandum is taken from Gardner, op cit., p. 300.

Silvermaster, a Treasury Department colleague of White, who photographed the documents and passed them to Soviet agents. Indeed, photographs of four pages of notes in White's handwriting later turned up among the documents plucked by Whittaker Chambers from his famous pumpkin. In his biography of Secretary of the Treasury Henry Morgenthau, Jr., on the other hand, Professor John Morton Blum says of White:

> . . . He appointed some assistants who were almost certainly members of the Communist Party, . . . and those assistants, in White's view were as free to pass along information about Treasury policy to the Russians as was Averell Harriman, for example, free to talk to the British. But White himself did not hew to the line of the Communist Party . . . .[68]

White's career began to decline after President Truman accepted Morgenthau's angry resignation on July 5, 1945, just before the Potsdam Conference. White stayed on as Assistant Secretary of the Treasury to Fred Vinson, who succeeded Morgenthau, but his influence waned, in part because the atom bomb seemed to render mute the issue of whether the "industrial disarmament" of Germany, advocated by White and Morgenthau, was needed to prevent a third World War. Indeed, in a few years, a restored West Germany would be sought after as a member of the Atlantic Alliance.

On January 23, 1946, President Truman nominated Harry White as the first United States Executive Director of the International Monetary Fund. This came as a bit of a surprise because it had been widely anticipated that White would be the Managing Director of the Fund, but FBI Reports about White were already being sent to the White House. On February 6. White was

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68. Blum, Roosevelt and Morgenthau, p. 46.

confirmed by the United States Senate, and the confirmation stood, even though Truman, Secretary of State James Byrnes and Secretary of the Treasury Fred Vinson were that very day discussing a new FBI report about White.

White resigned as Executive Director of the Fund on March 31, 1947.[69] In May, he moved to New York City and then to a small farm in New Hampshire from which he commuted occasionally to New York. In September, 1947, he suffered a severe heart attack and was unable to testify in October at a Grand Jury investigation of Elizabeth Bentley's accusations. The following August (1948), White voluntarily appeared before the House UnAmerican Activities Committee and read a statement which denied the accusations of Elizabeth Bentley and Whittaker Chambers. He added a ringing affirmation of "the American creed"[70] which drew applause. The next day, however, on his return by train to New Hampshire, he was taken ill with chest pains. Two days later, on August 16, 1948, he died at his summer home at Blueberry Hill.

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69. In February, just two months before White resigned as Director to the Fund, John J. McCloy, a prominent Wall Street lawyer, agreed to serve as the second President of the Bank. This was a bit of an irony, for McCloy had represented the War Department in interdepartmental discussions of American occupation policy in Germany while Harry White had represented the Treasury. In September, 1944, the Morgenthau (Treasury) Plan for dismantling German industry, substantially drafted by White, was approved by President Roosevelt over the objections of the War and State Departments. Roosevelt's vague decision was later reversed by Harry Truman, and, as High Commissioner to Germany beginning in 1949, McCloy helped to direct a German recovery which was greatly at variance with that sought by Morgenthau and White. American foreign policy was being directed by a new team.

70. See Rees, op. cit., p. 412. See also Van Dormael, pp. 306-7.

Even at the height of his career in the Treasury Department, Harry White had detractors. He was said to be arrogant and aggressive. British negotiators found him overbearing. Some State Department officials resented the intrusion of the Treasury Department into foreign affairs. From the vantage point of the Cold War, moreover, the One World notions of White and his colleagues seemed naive. White did not foresee that the super-powers of the world, each believing that it had won the war, would confront each other, each seeking to expand its hegemony beyond its pre-war boundaries. But he was not alone. Two months before his death, White commented:

> . . . I doubt if any responsible official of the member governments in spring of 1944 believed that by 1948 -- and only three years after the cessation of hostilities -- the tensions between certain of the major powers would have been so pronounced and that the world, instead of drawing together during these years, would have moved so precipitously toward a split . . .[71]

By September 11, 1947, when the Second Annual Meeting of the Fund and the Bank convened in London, the management of these organizations had set a course which would eventually make them indispensable to the peace and prosperity of the world. By then Keynes was dead, White had resigned, the Marshall Plan had been proposed, and the Bretton Woods organizations were facing a decade of relative inaction as the postwar transition proceeded in ways not foreseen at Bretton Woods. In 1947, the Fund and the Bank looked

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71. Cited without a source by Rees, op. cit., p. 391.

a bit like anachronisms whose time had passed before it had ever arrived. The foundations were strong, nevertheless, and the structures grew, in part because they were international in their origin and outlook. They were conceived in the spirit of One World.

Even today the notion persists that the people of the world must share the only liveable planet we know. It is a notion with a history which includes the negotiations at Bretton Woods four decades ago.