The Road to Bretton Woods

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TWENTY YEARS have passed since representatives of 45 countries met at Bretton Woods, New Hampshire, a summer resort in the northeastern part of the United States, to prepare the final texts of the Articles of Agreement of the International Monetary Fund and of the International Bank for Reconstruction and Development. Although the establishment of the Fund and Bank was a great stride forward in the development of the international payments system, it was a stride along a fairly well-marked path that ran, in the other direction, a long distance into the history of international monetary affairs.

In the nineteenth century the mechanism of international adjustment revolved around the gold standard, the development of which had begun in the preceding century. The pound sterling was linked to gold continuously from 1821 to the beginning of World War I. The "golden years" of the gold standard, however, lay in the period from 1870 to 1914, when Germany and other countries adopted it. Exchange arrangements were orderly under the gold standard. The rate of exchange between two currencies did not fluctuate outside the gold points—the rates at which it paid to import or export gold bullion. The money supply in a gold standard country was linked to the supply of gold, and gold coins were usually part of the circulating medium. Since an increase in a country's gold holdings exerted an expansionary influence on the money supply, and a decrease in a country's gold holdings a contractive influence, gold movements tended to harmonize price and cost relationships among the various countries. This constituted a force tending to maintain equilibrium in the balance of payments of gold standard countries.

There was a strong undercurrent of economic growth during the period before World War I. The industrial revolution that had first reached maturity in the United Kingdom was now reaching maturity in other countries. London, with a very highly developed money and capital market, was the world financial center, and the pound sterling was widely used as an international means of payment. There was probably more flexibility in prices and costs than exists today, but there were also sizable fluctuations in output and employment which were to some extent obscured by the secular growth trend, and also by a lack of statistics.

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The Gold Standard Abandoned

The gold standard was abandoned with the outbreak of World War I, and the international monetary system has never recovered the sense of solidity and permanence that went with it. The United States, it is true, went back on to gold in 1919, but the European countries delayed their return to the gold standard for some years—the United Kingdom until 1925 and France until 1928. Some of them, such as Germany and Austria, experienced rampant inflation before their currencies were stabilized. A number of economic and financial conferences were held during this period in an effort to evolve an acceptable system of international payments: for example, in Brussels in 1920 and in Genoa in 1922. The conferences passed resolutions about such matters as exchange rate stability, trade liberalization, and tariff reduction. Pursuant to the World Economic Conference held in Geneva in 1927, a draft Convention of Prohibitions was drawn up which contained definite commitments against the use of quantitative restrictions on trade and exchange controls except under certain specified conditions. But this Convention failed of ratification. Some progress was made, particularly at the Genoa conference, in developing a monetary standard in which gold no longer provided a common regulator of the quantity of money in different countries. The new system was called the gold exchange standard; under it many countries linked their currency to a "key" currency (the U.S. dollar had become a "key" currency, together with the pound sterling) which in turn was tied to gold. In most countries the use of gold as an internal circulating medium was not restored.

The Great Depression

This progress was brought to an abrupt end by the great depression of the early 1930's. Although this depression may be said to have started with the stock market crash in the United States in 1929, the raw material producing countries were among the first to feel its impact, in the form of a very sharp decline in prices, creating serious balance of payments problems. These problems of the raw material countries were not eased by the fact that, in 1930, the United States enacted the Hawley-Smoot Tariff, which provided for increased import duties on a large number of commodities. The depression spread to the European countries and there were extraordinary movements of capital; the famous Austrian bank, the Kreditanstalt, for instance, collapsed in 1931. The pound sterling was taken off gold in September 1931, and there followed an international wave of currency depreciation accompanied by trade restrictions, and in several cases by exchange controls, defaults on international debts, and various restrictions on international payments. In 1932 the United Kingdom and its associated countries in the Commonwealth negotiated a set of preferential tariff agreements. In March 1933 the United States dollar was taken off the gold standard at the same time that there was a collapse in the American banking system. Several countries in continental Europe (the so-called gold bloc) held out for some years, but finally they too had to abandon the gold standard.

During the world-wide depression of the 1930's the need for cooperation in the field of international trade and payments became especially clear. There was strenuous rivalry for foreign markets, each country taking measures which it thought would help to stimulate business activity within its own borders and increase its exports. In many countries, the currency was devalued (that is, its value in terms of foreign money was reduced) in order to lower export prices. All over the world, severe restraints were placed on international trade; in particular, exchange controls prevented the free use by exporters and others of foreign currencies which they had earned. Such restrictions hindered businessmen and consumers from buying wherever prices and quality were most attractive. But measures such as these, taken without concern for their effects on other countries, prompted reprisals.

The World Economic Conference in London in 1933, which attempted to deal with these problems, produced no immediate results. However, on the road back to recovery from the depression, the United States returned to a modified form of the gold standard in January 1934. Then, later in that same year, Congress passed the Reciprocal Trade Agreements Act, which empowered the President to lower U.S. tariffs in return for reductions in quotas and tariffs of other countries. The policy underlying the Trade Agreements Act was pursued vigorously in succeeding years and a substantial cut in tariffs was achieved.

One of the last countries to devalue its currency in the 1930's was France. In order to avoid exchange disturbances arising from this devaluation (in 1936), the United States, the United Kingdom, and France announced, in a Tripartite Declaration, their intention to consult on exchange policy. The Declaration also called for the expansion of international trade and the relaxation and ultimate abolition of exchange controls and quantitative restrictions on imports. The Governments of Belgium, the Netherlands, and Switzerland later stated that they too would adhere to these principles. Through the Tripartite Declaration, the signatory countries affirmed that problems connected with foreign exchange and world payments were matters of international concern. But the adherents were few in number and agreement was reached only in principle. The Declaration involved no binding commitment, and there was no machinery for continuous consideration of the problems involved. Above all, no common resources were provided.

World War II

Yet it was part of a movement, hesitant and difficult to discern as it may have been, toward the kind of payments system which was later made explicit in the Fund Agreement. Such as it was, the movement was interrupted by the outbreak of World War II in 1939, which brought increased use of trade controls, and caused the introduction of exchange controls in many countries where they had not been previously applied. But the war also created an opportunity for planning, for the postwar period, far-reaching changes in international economic cooperation.

This planning began early. In August 1941 the Atlantic Charter was negotiated between President Roosevelt and Prime Minister Churchill in a cruiser off Newfoundland. The fourth and fifth principles of this Charter provided that the countries adhering to it would "endeavor . . . to further the enjoyment by all states . . . of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity," and that these countries "desire to bring about the fullest cooperation between all nations in the economic field with the object of securing—for all—improved labor standards, economic development, and social security." This broad declaration of principles underlay the planning that took place for postwar international economic cooperation.

In the same period the United States negotiated with its allies a lend-lease arrangement under which the provision of supplies was not accompanied by the accumulation of precise financial obligations regarding repayment. Although the goods provided under lend-lease were to meet the urgent calls of war, the procedure under which they were supplied was designed with the long-term aim of avoiding the creation of huge war debts such as those which complicated the recovery after World War I. In the Mutual Aid Agreements underlying the provision of lend-lease supplies, the broad economic principles in the Atlantic Charter were set forth with greater precision. A typical formulation can be seen in Article VII of the agreement between the United States and the United Kingdom signed in February 1942. It provided that the terms and conditions of the settlement of lend-lease aid "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."

There was a provision for agreed action by the United States and the United Kingdom "directed to the expansion . . . of production, employment and the exchange and consumption of goods . . . to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers; and in general to the attainment of all the economic objectives set forth" in the Atlantic Charter. The lend-lease agreement went one step further: "At an early convenient date, conversations shall be begun . . . with a view to determining . . . the best means of attaining" these objectives. The principles of this Article were, in one way or another, formally accepted by 16 other governments before the end of the war, including the Soviet Union.

Financial Planning

As foreseen in Article VII of the lend-lease agreement, financial planning was pursued vigorously in both the United States and the United Kingdom, as well as in a number of other countries. In the United States there emerged a plan for a "United and Associated Nations' Stabilization Fund" as well as a plan for a "Bank for Reconstruction and Development." In the U.K. Treasury there emerged a plan for an "International Clearing Union." The Stabilization Fund and Clearing Union plans both provided for stable exchange rates, the elimination of restrictions on international payments, and consultations to restore balance of payments equilibrium. The big difference between the two plans was that the former contained a definite financial limit ($5 billion, the total of the resources to be contributed by member countries) while the latter contained an overdraft facility that, it was felt, might reach as much as $25 billion. The proposed bank was to have a capital of $10 billion subscribed by member governments and was to make long-term loans for reconstruction and development projects on sound financial principles.

Exploratory discussions on these plans were held in Washington in the summer and fall of 1943 by representatives of a number of countries. Out of these discussions emerged the "Joint Statement by Experts on the Establishment of the International Monetary Fund," which was published in April 1944. This was essentially a compromise between the U.S. and the U.K. plans; the total amount of resources was limited to $8.8 billion, and a clause permitting countries to discriminate against a country whose currency is declared scarce placed some of the burden of eliminating balance of payments deficits on creditor countries. The Joint Statement also provided for a transitional period during which members could employ exchange restrictions, and for a minimum of interference with internal policies. Time did not permit the preparation of a similar joint statement on the bank proposal, but the discussions indicated a large measure of agreement between the U.S. and U.K. experts, and the U.S. Treasury published its draft proposal for a Bank for Reconstruction and Development in November 1943.

Another round of discussions among U.S. and U.K. officials focused on commercial policy. Here, too, there were separate proposals —one a paper on a "Commercial Union" prepared in the U.K. War Cabinet Secretariat, and the other a document of the U.S. Department of State entitled "Multilateral Convention on Commercial Policy." The two plans were not dissimilar, but they did require reconciliation, and no real reconciliation was achieved at this time.

Although financial planning was pursued vigorously after the conclusion of the Mutual Aid Agreement, the first major conference called under the aegis of Article VII was on food and agriculture. International cooperation in the field of nutrition made a strong appeal to President Roosevelt, who saw in this an opportunity to launch postwar economic and social cooperation in an area in which conflicts of view, at least as far as aims were concerned, would presumably be less sharp than in the fields of trade and finance. A conference convened at Hot Springs, Virginia, in May 1943 led to the establishment of the Food and Agriculture Organization, which has its headquarters today in Rome.

Bretton Woods

Many persons considered the Hot Springs Conference a diversion from the main stream of negotiation, which was concerned with foreign exchange policy and international investment, on the one hand, and commercial policy on the other. In the former field, the ground was now laid for the Monetary and Financial Conference held July 1-22, 1944 at Bretton Woods in New Hampshire. To facilitate the work of this Conference a preliminary meeting of experts from 17 countries was held at Atlantic City, New Jersey in late June when British suggestions regarding the Bank (including the proposal that only a small portion of the Bank's capital be paid in) met with general approval by the other experts. The conferees went directly from Atlantic City to Bretton Woods where the actual terms of the agreements underlying the International Monetary Fund and the International Bank were worked out by representatives from 45 countries (including the Soviet Union). A year later, in July 1945, the U.S. Congress passed the law ratifying the Fund and the Bank Agreements; shortly thereafter the British Parliament passed a similar Act and in May 1946 the inaugural meeting of the Fund and Bank was held in Savannah, Georgia. In order to become a member of the Bank, a country must first become a member of the Fund. Thirty-eight countries were members at the time of the Savannah meeting; a handful of countries joined during or immediately thereafter. The Soviet Union has not joined the Fund. Poland and Czechoslovakia were at one time members, but later withdrew. Membership now totals 102 countries.

Once the terms of the Fund and Bank Agreements had been settled, discussions were resumed on the drafting of a commercial agreement. Talks held in Washington in the summer and fall of 1945 yielded a document entitled "Proposals for Consideration of an International Conference on Trade and Employment." In October 1946 a Preparatory Committee of the International Conference on Trade and Employment met in London and produced a draft charter of an International Trade Organization (ITO). In Geneva in the spring of 1947, a series of bargaining sessions resulted in a General Agreement on Tariffs and Trade (the GATT) which provided for specific tariff reductions; it was accompanied by a statement of general principles regarding the use of restrictions on trade. These general principles were similar to those in the draft charter of the ITO; they called for the removal of discrimination in international trade and for the reduction of tariffs and other trade barriers. In the winter of 1947-48, a conference met in Havana to draft the final agreement for the International Trade Organization. The Havana Charter that emerged from these discussions in March 1948 has not been ratified by participating countries, but they have used the GATT machinery to achieve somewhat similar objectives. At present, 61 countries are "contracting parties" to the GATT; delegates meet several times a year at the headquarters of the Secretariat in Geneva. Close cooperation is maintained between the Fund and the GATT in order to coordinate the work of the former in the payments field with that of the latter in the trade field.

It should be apparent from this review that the system of international payments implicit in the Fund Agreement evolved from discussions that started in the interwar period, and that it has been accompanied by related efforts at international cooperation in other fields, such as long-term investment and trade policy. There is no reason to feel that this evolutionary process has come to an end. The operations of the Fund and the International Bank have been changing in the nearly two decades that they have been operating. Studies of possible further changes in the international payments system are now under way by the Fund as well as by the ten countries participating in the General Arrangements to Borrow (see "Introduction to the Fund," Vol. I, No. 1, p. 14). Indeed, one is led to the conclusion that the forces working toward increased international economic cooperation enjoy substantial momentum. In this connection one is reminded of a quotation from Alfred Marshall's evidence before the Gold and Silver Commission (Question 10005, January 16, 1888): "I think that there is a real, though very slow-moving, tendency for national interests to overrule provincial interests, and international interests to overrule national, and I think the time will come at which it will be thought as unreasonable for any country to regulate its currency without reference to other countries as it would be to have signalling codes at sea which took no account of the signalling codes at sea of other countries."