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What the Bretton Woods system really was designed to do

by William Engdahl

The postwar Bretton Woods System was an international treaty agreement for regulating world trade, and monetary and financial stability. It evolved out of bilateral discussions beginning in 1942, during World War II, between the U.K. and the United States, regarding the desired postwar international monetary order. The chief negotiator of the basic proposals on the British side was the economist John Maynard Keynes, then an adviser to His Majesty's Treasury. Assistant U.S. Treasury Secretary Harry Dexter White represented the American side.

Following months of preparatory discussion by various working groups from the United States and Great Britain, on July 1, 1944, President Franklin Roosevelt convened a meeting of 44 nations in the resort town of Bretton Woods, New Hampshire, to discuss the proposed Joint Statement of Principles prepared by the United States and Britain for postwar monetary stability and economic reconstruction. The Bretton Woods talks concluded on July 22 with the unanimous adoption of proposals to create an International Monetary Fund (IMF) and a Bank for Reconstruction and Development, later simply called the World Bank.

In early 1945, the IMF and World Bank began operations, as the war neared an end.

The delegates at Bretton Woods, in addition to the United States and Britain, included representatives of most countries of the British Commonwealth, such as Canada, South Africa, and Australia, as well as Mexico, Argentina, Brazil, and other countries of Ibero-America.

Facilitating reconstruction

The primary problem which occupied the various countries' representatives present, was the desire to establish a stable basis to restore trade among nations, to facilitate the huge task of reconstruction of the economic infrastructure of Europe after the war.

With the experience fresh in mind of the devastating competitive import tariffs of the 1930s, and their attendant competitive currency devaluations, all of which were viewed as having led to the severe economic depression and, later, to World War II, the Bretton Woods parties were preoccupied with creating an international monetary system which would avoid those problems in the future.

The IMF and World Bank were created foremost to deal with the economic problems of the mainly European industrial countries which had been devastated by war. The less developed economies, or colonies, in Africa, Asia, or elsewhere, were viewed mainly as sources of raw materials which the industrial nations required, but were unable to import because of lack of hard currency. At that juncture, little attention was given directly to developing countries.

The foremost objective of the Washington group working on proposals for Bretton Woods, was to create an international treaty among sovereign nations to facilitate what they termed "the reconstruction of a multilateral system of world trade." The U.S. view at the conference was not the "free trade" view of Keynes and the British delegation. Indeed, despite the external appearances of intimate wartime cooperation between Washington and London, there was considerable behind-the-scenes friction in the days of Bretton Woods. One American delegate observed that tensions between the head of the American delegation, Harry Dexter White, and Britain's Lord Keynes, at one point were so great, that White began referring to the arrogant Keynes, whose bisexual proclivities were well known since his days with the notorious Cambridge Apostles, as "Her Majesty Keynes."

Rather than the Keynes system of free trade, Washington favored one which would encourage non-discrimination in trade barriers, a move aimed at dismantling Britain's imperial preference system, the Sterling Area trade club, with its colonies and Commonwealth. As well, Washington overruled Keynes's call for the IMF to become a global supranational central bank, with power to issue paper money, a global currency, not backed by gold.

The economic reality of the world as the 44 nations sat down to negotiate at Bretton Woods, was one in which the only industrial power with ample industrial base, and the capacity to provide urgently needed machinery and goods, as well as credit which would be everywhere accepted as a solid currency, was the United States. This was a major influence on the resulting structure of the Bretton Woods Agreement.

The Gold Exchange Standard

The core of the Bretton Woods System and the adopted IMF Articles of Agreement of 1944, was the arrangement for fixed currency parities. Exchange rates were to be changed in relation to the dollar or gold, only as a measure of last resort, and only after national policy measures had been exhausted. Following the war, the value of the British pound, the French

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Delegates from 44 nations gathered for the Bretton Woods International Monetary Conference, in New Hampshire in 1944. President Franklin Roosevelt convened the conference to restart world production and trade. Today, with the world facing a far worse crisis, Lyndon LaRouche has called upon President Clinton to convene a "New Bretton Woods" conference.

franc, the Swedish kroner, the Italian lira, and, after 1948, the German mark, all were fixed at agreed, more-or-less-permanent ratios to the American dollar. Long-term investment and trade relations could be undertaken on a stable currency background. Risk of dramatic currency losses was nonexistent under Bretton Woods at that time.

In turn, the American dollar was fixed to a specific weight of gold—a fine ounce of monetary gold was set equal to 35 U.S. dollars. The intent was to encourage member governments not to cheapen their currencies by simply printing money and running deficits, a major problem preventing stability in many European countries in the postwar period. In addition, the guarantee of fixed exchange was aimed to encourage the resumption of world trade as soon as possible.

The role of the dollar in the Bretton Woods system was unique, for good reason, in 1945. At that point, it was the only major currency, which was backed by the world's strongest and most productive industrial economy, the largest trading nation, and one which had ample gold to back the dollar. The U.S. dollar was, in short, the only currency regarded to be "as good as gold." European gold reserves had long since been drained by the costs of the war.

As the U.S. Federal Reserve System held some 65% of the world monetary gold reserves after 1945, it also made sense to establish what was called a Gold Exchange Standard, not the earlier, nineteenth-century British absolute Gold Standard, in which each country scrambled to accumulate maximum gold reserves.

Under the earlier Gold Standard, which had collapsed in the 1930s, European or other gold-standard central banks were able to print paper money only in agreed fixed ratio to the amount of their physical monetary gold reserves. If they were forced to sell that gold to stabilize their currency, domestic credit had to contract accordingly, that is, deflate. That deflation had been one of the most savage aspects aggravating the economic crisis of the 1930s in those countries which remained on the Gold Standard after September 1931.

Under the Bretton Woods Gold Exchange Standard, the dollar was considered an acceptable substitute for central bank reserves, i.e., "as good as gold." An IMF member country's central bank was therefore allowed, under the Gold Exchange Standard rules, to issue currency in the defined ratio, against its reserves of dollars as well as its gold. The intent was that for European economies after the war, the process of non-inflationary credit creation would thereby be made far easier, and encourage strong rates of needed industrial investment and reconstruction. The World Bank had been created as the vehicle to extend reconstruction dollar loans to the governments of Europe.

The dollar would function for almost the next quarter-century, until the end of the 1960s, as the accepted substitute for gold. The rates of investment and real economic growth during especially the 1950s were made possible by this stability anchored on the dollar-gold exchange standard of Bretton Woods.

The control over an IMF member-country under the Bretton Woods system, against cheapening its currency via domestic money printing, was the ultimate IMF rule that a country, say, Britain in the 1960s, must redeem its pounds in gold from the Federal Reserve or IMF. This, not in cheapened currency, but rather, in a fixed parity to the Bretton Woods currency rate. The International Monetary Fund was not intended to be a world austerity policeman, as it has become today. Rather, it was intended to act as a financial pool of

dollars and gold reserves of each member-state, used to extend short-term emergency loans, until a member-country could impose economic policy changes to correct a balance of payments problem before it became serious. In short, it was to be a stabilizer of advanced industrial economies whose own inherent basis for recovery and growth was essentially strong, but for the destruction and disruption of the war. The Bretton Woods system was never intended to regulate growth of emerging countries or developing economies.

In the immediate postwar years, until approximately 1958, when European currencies were able to become fully convertible, the fundamental problem for trade and economic reconstruction in western Europe was the so-called dollar scarcity. Dollars were necessary to settle trade between European countries or with third countries. Britain would not accept the French franc in payment, because it was not yet stable enough to be convertible. France needed dollars to pay for imports of British industrial goods. Similarly for Italy, for import of German machinery, for example.

As a corollary, under the Bretton Woods gold exchange system, with the dollar as the central reserve currency, unilateral dollar devaluation by the United States was ruled out. Only upward revaluation of other non-reserve currencies was allowed, as their economies recovered from depressed postwar conditions and began to build surplus currency balances. By the late 1960s, the rule prohibiting dollar devaluation was to become a central factor in the ultimate breakdown of the Bretton Woods system.

The pound and the breakdown of Bretton Woods

By 1958, the Bretton Woods system of fixed exchange rates became fully operational, some 13 years after the IMF began to function, when the mark, pound, and other currencies became fully convertible, not only for national central banks, but for private business transactions, into dollars or gold. (The point is worth noting, when compared with IMF demands after 1992 that Russia, Ukraine, Poland, and other former state-run economies move, more or less immediately, to full currency convertibility.)

Under the rules of Bretton Woods, foreign central banks could take the dollars that they had accumulated, and redeem them for gold at the New York Federal Reserve's Gold Discount Window. The gold bars physically remained in New York, but the gold was credited and registered with the IMF as transferred, on the account of the Bank of France, or Bank of England, or whichever. Before 1965, the amount of such transfers had been relatively small.

After European currency convertibility in 1958, American banks were able to make large international loans to French, Belgian, German, Italian, and other European economies starved for dollars, to import needed American machinery and goods. The currency convertibility assured lenders that the value of the loan would remain constant over time. As well, American corporations could, with little risk, come to France or other European countries with dollar balances, and invest in companies, exchanging their dollars, under rules of free convertibility, for French francs.

French fear of being completely bought up by American companies during the 1960s became almost a national obsession, leading to such famous books as Jean-Jacques Servan-Schreiber's *The American Challenge,* an effort to arouse French anxieties about American investment in Europe.

In early 1965, against such a backdrop of French concern about an American corporate "invasion," a French intervention changed the entire perspective for the future of the Bretton Woods arrangement. Instead of holding dollar balances, usually invested in U.S. Treasury securities to earn interest, European central banks, especially the Bank of France, and later, the Bank of England, began to redeem dollars and demand U.S. Federal Reserve gold instead, for the first time in large amounts.

On Feb. 4, 1965, France's President Charles de Gaulle called for abandonment of the Bretton Woods Gold Exchange Standard, and a return to the nineteenth-century Gold Standard, as had been created by London. By that time, the Bank of France had accumulated a large gold hoard, and felt itself in an advantageous position for such a move.

De Gaulle called for creating a new system, "on an unquestionable monetary basis that does not bear the stamp of any one country in particular." On what basis? "Truly it is hard to imagine that it could be any standard other than gold," said de Gaulle. "Yes, gold, whose nature does not alter, which may be formed equally well into ingots, bars, or coins, which has no nationality, and which has, externally and universally, been regarded as the unalterable currency."

The best method of "terminating the gold exchange standard without causing a hard jolt, and the restoration of the gold standard," de Gaulle added, must, of course, "be examined calmly." De Gaulle had taken the proposal of his adviser, Jacques Rueff, against the contrary advice of his own Ministry of Finance and Bank of France.

The reaction to de Gaulle's bombshell was anything but calm. The United States argued vehemently against his proposal. It rejected his call that it agree to a major revaluation of the price of monetary gold by 100%, to allow it to buy back its dollar reserves in European central banks with gold, and as well, in order to establish a price high enough to encourage increased mining of gold around the world.

Washington argued that that would have meant a devaluation of the dollar by 100%, destabilizing the entire world trading system. Further, such a large increase in the price of official gold, Washington argued, would have enormous consequences for the conduct of the Cold War. The major beneficiary, aside from South Africa, would be the Soviet Union, the world's second-largest gold producer. It could sell its gold at enormous profit to finance import of Western technology to modernize its economy, weapons systems, and further tighten control over the captive satellite states of eastern Europe.

France was not impressed. De Gaulle immediately ordered

conversion of $300 million, a huge sum for that day, held by the Bank of France, into gold, at the New York Federal Reserve Gold Discount Window. From that point, France began to take monthly redemptions of dollars for U.S. gold. Others central banks followed, but none so aggressively as France.

The Vietnam War of the 1960s proved the ultimate undoing of the Bretton Woods system. With huge public deficits used to finance the cost of the unpopular war without imposing unpopular new taxes, year after year, foreign central banks built up large dollar accumulations, the so-called "Eurodollar" market. After de Gaulle's call in 1965, the European central banks, especially the Bank of France, began to convert more of those dollar reserves into gold from the U.S. Treasury.

Pressure began to focus about that time on the weak link of the Bretton Woods system, the pound, which had a peculiar status, partly because of Keynes's influence and British demands in 1944 that it be the so-called second reserve currency, next to the dollar, for Bretton Woods, because of England's monetary ties to its colonies at the time.

The British economy began running huge chronic balance of payments deficits in the mid-1960s, in technical defiance of Bretton Woods rules. The United States and others joined in extending Britain emergency dollar loans to try to stabilize the problem, but the Labour government policy of maintaining full employment made matters worse. Finally, by November 1967, the U.K. government announced that it would devalue the pound by 14%. This collapse of the pound, and its unilateral devaluation, then brought into question the entire basis of Bretton Woods fixed exchanges, most immediately the U.S. dollar.

By late 1967, U.S. inflation, owing to the huge Vietnam War spending and now-chronic balance of payments deficits, was also worsening dramatically. The economies of Japan and West Germany, especially, as well as of France, by contrast, were emerging as major advanced export economies, with ever-larger balance of payments surpluses.

In light of this now-obvious divergence from the situation of the immediate postwar years, speculators began record private gold purchases in London after 1967, and shifted funds out of dollars into francs or marks. They were betting that the dollar would soon be forced to devalue against gold and the main European currencies.

De Gaulle encouraged the shift. A Gold Pool of the ten leading industrial countries, led by the United States, had agreed in 1963 to pool gold reserves to hold the Bretton Woods parity stable, by selling their pooled reserves of gold in the London market. However, as more gold came onto the London market, speculators bought more, in the conviction that, ultimately, the Bretton Woods fixed exchange must crack. By June 1967, de Gaulle unilaterally pulled France out of the London Gold Pool, weakening it significantly.

Over a six-month period, from October 1967 just prior to the pound's devaluation, to April 1968, the Gold Pool countries were forced to sell a staggering $3.5 billion in gold, to calm speculation that there would be a dollar devaluation of the Bretton Woods system. That meant a U.S. loss of some 20% of its gold reserves. By March 1968, the Gold Pool officially dissolved, and a two-tier private and official gold market was agreed upon, in which private gold could be bought or sold at market price, and official central bank gold only at $35 per fine ounce.

By the end of 1969, the U.S. economy had fallen into a major recession. By 1970, the Nixon administration and the Federal Reserve had eased monetary policy to lower interest rates and stimulate domestic growth. International currency speculators reacted immediately with a major attack on the dollar. By 1971, as a U.S. recession worsened and Nixon faced a hard re-election campaign, inflation and easy money from the Federal Reserve were stepped up under political pressure from the White House.

Nixon had appointed his old friend Arthur F. Burns, later ambassador to Germany, as chairman of the Federal Reserve in January 1971. Burns accommodated immediately, as Nixon indicated his desire that the "independent" central bank turn on the printing presses and revive the depressed economy in time for Nixon's 1972 re-election campaign. Nixon told the press at the time of Burns's appointment, "I respect his independence. However, I hope that independently he will conclude that my views are the ones that should be followed." Within two weeks of his appointment, Burns began to lower interest rates and increase money supply to stimulate the domestic economy.

That flood of money led to a torrential outflow of short-term funds from the United States. Such money flight reached $6.5 billion in 1970, and soared to $20 billion by 1971. Nixon's government budget deficit was rising accordingly, from $10 billion in 1970, to an unheard-of $30 billion in 1971.

By August 1971, U.S. official gold reserves had fallen to only half that of 1958. More alarming, in terms of covering U.S. external liabilities, U.S. gold reserves represented only 25% of total future claims on U.S. gold by foreign central banks holding dollars. Theoretically, were all central banks at once to demand gold for their dollar reserves, the United States would be unable to pay. The Bretton Woods Gold Exchange Standard was near rupture.

In the first days of August 1971, the U.S. Treasury had received reports of a planned concerted run by European central banks on the remaining U.S. official gold reserves. That attack was to have been led by the Bank of England and the Bank of France. But, before it could take place, on Sunday, Aug. 15, 1971, President Nixon announced to a startled world that, no longer would the United States Federal Reserve honor its obligations under the Bretton Woods Treaty to redeem dollars for gold. The dollar, as well as other major world currencies, were to float.

By 1973, this free-floating currency system had officially replaced the Bretton Woods system, opening the door to creation of what Rueff called fiat money, or "printing press" money. Gold left the monetary system, for all intents and purposes.