The Myth of Bretton Woods

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> *If 'the Bretton Woods system', as conceived in 1944, ever existed it ended in 1947. What later emerged in 1958, when Western European currencies became more or less fully convertible, was certainly based on very similar economic ideas, but was, none the less, something different.*[1]

Alan Milward has argued that "the Bretton Woods system" is a misnomer; that the economic recovery of western Europe after World War Two depended in large part on jettisoning the central provisions of the Bretton Woods agreements; that even after the successful recovery of the west, the terms of the Bretton Woods agreement were never really implemented; and that the division of post-war economic history into two periods, "the Bretton Woods system" and the period of floating exchange rates that followed, is wrongheaded. It is wrongheaded, he argues, because such an analysis fails to clearly identify how very different the actual conduct of international economic affairs was from the plans devised in New Hampshire in 1944, even during the supposed heyday of the system in the 1960s, and especially because such an arbitrary division of recent economic history masks rather than highlights the critical role played by the institutionalised interdependence of western European states in defining the terms of the post-war political and economic settlement.[2] In short, the Bretton Woods system was a myth in the sense of a falsehood: there ain't no such animal.

I use these bold assertions as a jumping off point for a discussion of the transformation of the international monetary system in the period immediately following adoption of the Bretton Woods agreements. The Bretton Woods architects intended to fashion an international monetary order that would provide maximum autonomy for national economic policy, upending the priorities of the classical gold standard. This emphasis on national prosperity was reflected in the contemporary analyses of both Karl Polanyi and Ragnar Nurske, each of whom argued that domestic economic stability needed to form the core of the new international economic system—a concept later termed "embedded liberalism" by John Ruggie.[3] But the system finally agreed at Bretton Woods was already considerably weaker and less coherent than the original plans of either John Maynard Keynes, the chief British negotiator of the accord, or Harry Dexter White, his American counterpart. Disagreements within the Roosevelt administration resulted in a much more ambiguous formulation than either of the two original architects desired, particularly on the issue of control of capital movements. Soon the infant system faced challenges not only on this front but indeed on all its major postulates. Within a generation the practices of "the Bretton Woods system" were so completely different from its founding precepts that even leading scholars had confused the two—and not just superficially.

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[1] Alan S. Milward, *The Reconstruction of Western Europe 1945-1951*, London: Routledge, 1984, p. 44.
[2] In addition to the above quotation, see Milward 1984, pp. xvi, 43-44, 462-464, and 476-477.
[3] Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, Boston: Beacon Press, 1944/1957; Ragnar Nurske, *International Currency Experience: Lessons of the Interwar Experience*, Geneva: League of Nations, 1944; John Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization* 1982 (36): 379-415.

The institutional pivot of this transformation was central banking. The original Bretton Woods design had been intended to export the progressive policies of the Roosevelt administration to the rest of the world, including the subjugation of national central banks to the state (following the American pattern). But this subjugation turned out to be far from permanent. Indeed, by the 1960s the US government had turned to its central bank, and to the Federal Reserve Bank of New York in particular, to rescue what remained of the Bretton Woods order from its own excesses. The result was the creation of a system substantially at odds with the original Bretton Woods framework but nevertheless widely characterised since then as the heyday of the Bretton Woods system.

By this point "Bretton Woods" had become a myth in more than the sense of a mere historical untruth. For many it had come to represent the agreement of national governments to cooperate in resolving their (macro) economic differences, rather than their willingness to do so within a particular regulatory and institutional framework. This helps account for the otherwise astonishing difficulty scholars have in determining when the "system" had ceased to function. Was it in 1947, with the announcement of Marshall aid?[4] Or in 1965, with de Gaulle's call for a return to the gold standard?[5] Was it 1971, with Nixon's closing of the gold window?[6] Or in 1973, with the shift to floating exchange rates?[7] Absent agreement about what the system actually entailed, little wonder there is such a variety of opinions about the date of its passing.

From Bretton Woods to Basel

This paper is part of a larger project examining the role of central banks and central bank co-operation in transforming the political economy of the late 20th century. How did central bank independence—an organizational arrangement that was thoroughly discredited in 1944—become the global standard just half a century later? As we examine the historical trajectory of central bank independence, the 1960s appear as critical juncture, especially the sometimes *ad hoc* arrangements developed during that decade with the aim of buttressing the Bretton Woods machinery. These arrangements—the so-called "perimeter defenses" of the US dollar[8]—eventually involved almost every dimension of foreign economic policy, including financial aspects of military policy. Finance, trade, and defence ministries were all enlisted in the cause of preserving the fragile monetary system. In the end, however, sustaining the entire framework of international monetary co-operation came to depend on the single, slender reed of central bank co-operation as organised

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[4] Milward 1984, p. 44.

[5] Robert Gilpin, *The Political Economy of International Relations*, Princeton: Princeton University Press, 1986, p. 134 (131-142).

[6] Susan Strange, *International Economic Relations of the Western World, 1959-1971, Volume 2: International Monetary Relations*, London: Oxford University Press, 1976, p.355; Benjamin J. Cohen, *Organizing the World's Money*, New York: Basic Books, 1977, p. 90; Robert O. Keohane and Joseph Nye, *Power and Interdependence: World Politics in Transition*, Boston: Little, Brown and Company, 1977, pp. 81-82.

[7] Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System*, Princeton: Princeton University Press, 1996, p. 136; but see also 3, in which he argues that the system ended in 1971.

[8] The term, sometimes called the "outer perimeter defenses," was coined by US Treasury Undersecretary for Monetary Affairs Robert V. Roosa.

on the outskirts of the monthly meetings of the Bank for International Settlements in Basel.

This development was not foreseen and, in the eyes of many, not desired. A leading role for national central banks in the management and preservation of the international monetary system was certainly not what the Bretton Woods planners had envisaged, and the international monetary system that the central banks developed was in many ways the polar opposite of that intended by the authors of the Articles of Agreement. But no other mechanism of statecraft proved up to the task, and central banks from the world's leading financial powers were eventually, and in some cases quite reluctantly, called upon to rescue what was then left of the Bretton Woods plan.

This decision had profound implications for the subsequent evolution of national political economies, and of the international political economy more generally. In the United States, the increasing reliance of the government on the Federal Reserve System, and especially the Federal Reserve Bank of New York, to organise international operations in support of the dollar enabled the Fed to resume an important and relatively independent role in the policy-making process, a role that had been shorn of it during the New Deal (and which it came close to losing again during the Nixon administration). In Europe, the reliance of governments on central bank co-operation during the 1960s created a series of institutional arrangements that influenced the future shape of policy at both the national and European levels. First, it tended to enhance the authority of central banks that were already somewhat influential within their domestic political economies, such as the Bundesbank within the Federal Republic of Germany. Second, it gave rise to a forum where general questions of economic and monetary policy, including relations with the United States and, very importantly, European monetary integration, could be discussed, and from which European central bankers could exercise considerable and in some cases decisive influence over joint policies—reflecting a degree of influence that they did not always enjoy in their national settings.

These larger arguments cannot be fully developed in this short paper, nor can a detailed chronology of central bank co-operation be enumerated. But we can examine the flawed agreement at Bretton Woods that helped give rise to the crisis of the 1960s—a crisis that the central banking community readily responded to. Thus in this paper I limit myself to describing the Bretton Woods agreement itself, and the intellectual and policy assumptions behind its adoption. I then turn to a discussion of how these assumptions were soon challenged, sometimes by events, sometimes by rival conceptions. Finally, I provide a very brief overview of how actual practice conformed to, and diverged from, the Bretton Woods plan in the years immediately following its adoption.

Bretton Woods: the original plan

There is a certain irony that the resort town of Bretton Woods, New Hampshire has come to represent international co-operation in monetary affairs and in the management of the international financial system. It was not the woody isolation afforded by the Mount Washington Hotel but the parochial politics of national coalition building that determined the conference location. The timing of the conference was designed to finalise agreement before the November 1944

congressional elections, in which the Republicans were expected to make major gains; the location, in the Mount Washington Hotel of the resort town of Bretton Woods, was intended to help woo the state's incumbent Republican senator.[9]

The very notion of holding an international conference to chart the institutional configuration of the post-war world while the outcome of the single largest military conflict in human history was still in doubt was audacious. But the Bretton Woods conference was nothing if not audacious. Speaking at its inaugural session, US Treasury Secretary Henry Morgenthau framed its goals thus:

> *I hope that this conference will focus its attention upon two elementary economic axioms. The first of these is this: that prosperity has no fixed limits. It is not a finite substance to be diminished by division. On the contrary, the more that other nations enjoy, the more each nation will have for itself...*
>
> *The second axiom is a corollary of the first. Prosperity, like peace, is indivisible. We cannot afford to have it scattered here or there among the fortunate or to enjoy it at the expense of others. Poverty, wherever it exists, is menacing to us all and undermines the well-being of all the more-favored areas of the earth.*[10]

These two axioms may have been elementary, but they were also radical departures from the orthodoxies of the 1930s. Morgenthau's first point militated for an overarching international approach to economic welfare, whereas economic theory of the interwar period had been virtually silent on international issues. And his second point explicitly linked economic structures with the creation of a new international political order. That order would be multilateral in character,[11] and would include among its organising principles the notion that redistributive policies like those at the core of the new domestic economic thinking had international corollaries as well.

More immediately, the object of the conference was to create a system that would permit national economic policy autonomy to co-exist with a great expansion in international trade.[12] As early as the signing of the Atlantic Charter these objectives had been publicly embraced by the governments in Washington and London. The two points were later married in the first article of the IMF charter, wherein "the purposes of the International Monetary Fund" were defined to include:

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[9] See Eichengreen 1996, p. 97, fn. 7.

[10] Cited in Harold James, *International Monetary Cooperation Since Bretton Woods*, Washington, DC: International Monetary Fund, 1996, p. 56.

[11] Although the term "multilateral" had yet to enter the political lexicon with its present meaning; see the discussion in James N. Miller, "Origins of the GATT: British Resistance to American Multilateralism," *Working Paper No. 318*, Jerome Levy Economics Institute at Bard College, 2000.

[12] The primacy of national stability was made explicit in the work of Nurske ("a system of international currency regulations compatible with the requirements of domestic stability;" 1944, p. 10), and in both the Keynes and White Plans. As for the trade component, the White Plan opens with the following statement by US Treasury Secretary Henry Morgenthau: "It is generally recognized that monetary stability and protection against disciminatory currency practices are essential bases for the revival of international commerce and finance." In Horsefield 1969, p. 83.

to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.[13]

Similar domestic objectives—especially full or near-full employment and income growth—had become the mantra of national economic policy in numerous states, and in many cases had been or would soon be adopted into the legislative framework of government.[14] Broad commitments for later trade liberalisation were undertaken during the war as well, often at American insistence, but these were more controversial. Concrete negotiations on post-war trade relations were considered too sensitive and potentially too divisive to be undertaken by allies in a desperate military campaign. This calculation was probably correct; trade negotiations did begin immediately after the war's end, first between the US and Britain and later on a multilateral basis, and ended in acrimony, mutual recrimination, and the collapse of efforts to establish a genuinely international juridical framework to govern trade relations.[15] Trade expansion was embraced as a principle by the allies, but only at a high level of abstraction.

On the other hand, it was believed that a monetary framework accommodating both trade growth and economic policy autonomy could be agreed upon during the war, in order to lay the groundwork for the difficult trade negotiations to follow. Indeed, the draft White Plan of April 1942 argued that "specific proposals" on the subject of a future monetary order "will help win the war" by providing

...assurance that a victory by the United Nations [i.e., the war-time coalition] will not mean in the economic sphere, a mere return to the pre-war pattern of every-country-for-itself, or inevitable depression, of possible widespread economic chaos with the weaker nations succumbing first under the law-of-the-jungle that characterized international economic practices of the pre-war decade.[16]

In addition, both the British and American plans were partly aimed at undermining German propaganda efforts concerning the "New Order," the Nazi economic program for conquered Europe, which had a substantial monetary dimension of its own.[17] In the lengthy preliminary negotiations that eventually led to Bretton Woods, Washington and London were looking to cement their own wartime military commitment, and to inspire others to either join or remain in the fight against the Axis powers, by devising a mutually agreeable framework for the world's economic future that would compare favourably with the Nazi program. Preparations towards this end had begun as early the summer of 1941, following the decision of the US government to demand an end to the discriminatory practices of the British empire as "the consideration" received by Washington as part of the terms of the Lend-Lease

[13] The original IMF Articles of Agreement are reproduced in Horsefield 1969, vol. III, pp. 185-214; all further citations are from this source.
[14] See cf. Peter A. Gourevitch, *Politics in Hard Times: Comparative Responses to International Economic Crises*, Ithaca, NY: Cornell University Press, 1986.
[15] See Miller 2000.
[16] In Horsefield 1969, p. 38. A somewhat cleaner version of this rationale was reproduced in the final (official) version of the White Plan (p. 84).
[17] See the discussion and notes in James 1996, p. 34.

Agreement. The British government immediately enlisted the services of John Maynard Keynes to draw up a proposal for post-war currency arrangements that would render this development less threatening to the United Kingdom's fragile economic interests.[18]

To briefly summarise the two governments' positions, British negotiators hoped to avoid a return to the inter-war monetary system with its substantial biases against net debtors (a position that the United Kingdom was bound to occupy for the foreseeable future). US negotiators were sympathetic to this concern but equally determined not to permit profligate governments unlimited access to the resources of creditor states (a position the US was equally bound to occupy after the war). Discussions focused on questions of exchange-rate arrangements, currency convertibility, international liquidity, and the control of capital movements. *Exchange rates* had been used during the inter-war period as instruments of discriminatory trade policy, particularly within Europe; there was therefore a strong bias against any framework that would permit this to recur. *Convertibility* of national currencies into gold and foreign exchange represented a form of external discipline on national policy. While it was recognised that some degree of discipline would be necessary to insure the minimal conditions of successful policy co-ordination, there was nevertheless a strong bias against any arrangement that would subordinate the national economy to international market forces, as had been the case under the gold standard. Hence there was a corresponding debate about the forms that international *liquidity* (or official reserves) would assume. Finally the question of *capital controls* was central to discussions, given the strong association drawn by most analysts between speculative capital movements and the exchange-rate instability of the 1930s.

The agreements finally reached at the Bretton Woods conference wove each of these elements into a more or less coherent whole—or at least they appeared to do so. The delegates endorsed policies aimed at exchange-rate stability and currency convertibility in the context of a new system for the provision of official liquidity; they also endorsed a system of national and international capital controls. To insure compliance with these rules, to regulate the provision of official liquidity, and to provide a forum for the exchange of views and the promotion of policy co-ordination, they invented the International Monetary Fund and, as a subsidiary institution, the International Bank for Reconstruction and Development (or World Bank). Finally, to eliminate rival forums that might be hostile to these objectives, they advocated the destruction of the Bank for International Settlements.[19]

But almost every element of this mosaic was subsequently undermined. The reliance on capital controls was challenged first, indeed before the conclusion of the conference; but eventually the key tenets of the agreement on currency convertibility, the sources of official liquidity, and even exchange-rate stability were abandoned. The IMF survived, but was never really able to perform its central statutory functions.

[18] See James 1996, pp. 33-36.

[19] Resolution V at the Bretton Woods conference called for the liquidation of the BIS "at the earliest possible moment." This qualifying language may have represented British hesitancy to insist upon dismantling the BIS as a necessary precondition of the Fund's creation (as James 1996, pp. 49-50 argues), or it may simply have been an implicit acknowledgement that the institution was at least temporarily out of reach in neutral Switzerland, surrounded by German-controlled territory (for this argument see Eric Helleiner, *States and the Reembergence of Global finance: From Bretton Woods to the 1990s*, Ithaca, NY: Cornell University Press, 1994, pp. 53-54).

More importantly, the BIS survived as well, and central bank co-operation re-emerged as the primary mechanism for international collaboration in managing the international monetary system. But before turning to the system's transformation, let us consider more closely the basis of the original understanding.

Exchange rate stability

The consensus of economic experts on the deficiencies of the inter-war monetary order was relatively clear.[20] Restoration of the gold standard had contributed to the Great Depression, and subsequently to the rise of fascism in Europe and Japan, in three related but distinct fashions. First, the gold-exchange standard of the 1920s and 1930s had transmitted local economic shocks throughout the international system. Second, the monetary system had suffered from a general deflationary bias in its arrangements. These two features had in concert tended to encourage defection from the system, and such defections had aggravated existing tendencies towards trade protectionism—the third means by which the international monetary order had played a role in economic collapse and political extremism.

The first two of these problems—shock transmission and deflationary bias—related to the payments adjustment mechanism of the gold-exchange standard, the framework for international monetary relations to which most countries of the world had returned by the late 1920s. The transmission of economic shocks was due to the system's core principle of fixed exchange rates. Without exchange-rate flexibility, adjustment to deficit-producing shocks could not take the form of raising the relative prices of tradable versus non-tradable goods;[21] instead, deficit adjustment had to occur through reductions in national income through some macroeconomic channel.[22] For its part, the deflationary bias resulted from the asymmetry of adjustment obligations in the system: deficit states had to either contract their economies or leave the gold standard, but surplus states were under no offsetting obligation to expand their economies. Both these features were politically sustainable when national politics was essentially an elite-driven process, and when mass expectations regarding governments' economic responsibilities were relatively low. But in the context of mass political parties and heightened economic expectations that had generally prevailed among developed states at least since the end of the First World War, and in some countries even earlier, neither characteristic was considered politically viable.[23] Moreover, the combination of these two features made the system extremely susceptible to shocks, whether price shocks (as was the case with commodities beginning after 1925) or financial shocks (beginning with the collapse of Vienna Creditenstalt in 1931).

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[20] On the war-time academic consensus regarding exchange rates and its subsequent breakdown, see Michael Bordo and Harold James, "Haberler Versus Nurske: The Case for Floating Exchanges Rates as an Alternative to Bretton Woods?," The Adam Klug Memorial Lecture, *Working Paper 8545*, National Bureau of Economic Research, October 2001.

[21] So-called "expenditure-switching policies."

[22] So-called "expenditure-reducing policies."

[23] Changes in the willingness of mass publics to tolerate deflation is a major feature of the analysis in Milward 1984, Eichengreen 1996, and James 1996. Dani Rodrik, in "Governance of Economic Globalization" (in Joseph S. Nye and J. D. Donahue, eds., *Governance in a Globalizing World*, Washington, DC: Brookings Institution Press, 2000) incorporates it into a generalized schema or "tilemma." But the concept figured in earlier analyses of international monetary relations as well (cf. Cohen 1977, pp. 86-87).

It was this susceptibility to crisis that most troubled policymakers, and this related to the third perceived deficiency of the gold-exchange standard: its tendency to break down periodically, leading to various abuses exacerbating trade protectionism. Whatever the deficiencies of fixed rates, there was little stomach in either official or academic circles for an international monetary system based on exchange-rate flexibility.[24] Flexibility meant discretion, and discretion was closely associated with discrimination—a lasting impression left by the Nazi experience.[25]

This certainly was the academic consensus. In an influential study of the inter-war currency experience commissioned by the League of Nations, Ragnar Nurske argued that exchange-rate depreciation had played two important functions during the 1920s and 1930s, first as "a fitful and unreliable method of attracting foreign funds to replenish the national working capital, a method depending on the interplay of speculative anticipations" and second as a means for gaining competitive advantage for capital exports. But neither of these potential gains from currency movements was everlasting; instead, temporary benefits were offset by corresponding movements in the currencies of economic rivals. Thus the supposed benefits of either competitive devaluations or of floating exchange rates were illusory.[26]

While Nurske was the primary author, the League study very nearly represented a collective work, given the very substantial pains the author went to consult the leading lights of the economics profession.[27] And Nurske was certainly familiar with the views of the profession. He had studied in Edinburgh and then Vienna, where he worked with Gottfried Haberler, Friedrich von Hayek, Fritz Machlup, Ludwig von Mises and Oskar Morgenstern. He then took a position with the League of Nations Financial Section in Geneva; with the advent of the war that unit was moved to Princeton, where he worked with J.B. Condliffe, Marcus Fleming, Floke Hilgerdt, Jacques Polak, and Louis Raminsky. Nurske's main duty at Princeton was preparation of the League's report on lessons from the monetary experience of the 1920s and 1930s; this report was then circulated to the delegations at the Atlantic City meeting that prepared the formal agenda for the Bretton Woods conference (the United Nations Monetary and Financial Conference).[28] Thus Nurske's work

[24] This statement requires qualification. Certainly the British team was more anxious to permit a limited degree of exchange-rate flexibility than was its American counterpart. For example, Keynes' original proposal held that "our British problem of gaining enough receipts overseas to balance our import requirements is so acute that we can scarcely hope to solve it except though a scheme which...affords us the possibility of subsequent rectifications of the rate of exchange against the rest of the world...in the event of the initial value of sterling proving to be higher than the level at which we can balance our overseas trade." But the passage goes on to add that the aim is such rectification "without the risk of competitive depreciations or of complaints by other countries" in such an event—in other words, a system whereby periodic changes in the exchange rate could take place without setting off a chain reaction of recriminations and corresponding shifts in other currencies' exchange rates. See Horsefield 1969, p. 17.

[25] The classic study remains Albert O. Hirschman, *National Power and the Structure of Foreign Trade*, Berkeley: University of California Press, 1980/1945.

[26] Nurske 1944, p. 115.

[27] Note that Chapter VI of this work, concerning exchange stabilization funds, was not written by Nurske; see Bordo and James 2001, p. 8.

[28] In this context the United Nations referred to the allied nations, not to the as yet uncreated institution headquartered in New York.

represented the official consensus view of the economics profession regarding the relationship between national economic policy, international trade and exchange rates.

In seeking the golden mean between excessive rigidity and fluidity, the League study rejected small and frequent changes in currency's parities—even if these could be internationally negotiated. "The more frequent the exchange adjustments, the stronger are likely to be the disequilibriating tendencies not only in the capital flow but also in the movement of trade; the more frequent and disturbing will be the internal shifts of labor and other resources; the more seriously will exchange risks hamper trade."[29] Thus "changes in exchange rates are likely to be more effective the less frequently they occur. Exchange stability should be the norm and exchange adjustment the exception."[30] The objective should therefore be a system in which parities would initially "be made by mutual consultation and agreement," and subsequent changes "should not be altered by arbitrary unilateral action."[31] Indeed, the absence of a permanent forum for multilateral consultation was one of the failings of the inter-war system. Consultations were an essential means to promote policy co-ordination and, in Nurske's view, "it was partly because of the lack of proper coordination during the stabilization period of the twenties that the system broke down in the thirties."[32]

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The solution agreed upon at Bretton Woods followed a similar logic. Exchange rates would be both fixed (in the medium term) and flexible (in the long term). Thus Article IV of the IMF Articles of Agreement held that "the par value of the currency of each member shall be expressed in terms of gold as a common denominator" (Section 1a). Furthermore, "each member undertakes to collaborate with the Fund to promote exchange stability, to maintain orderly exchange rate arrangements with other members, and to avoid competitive exchange rate alterations" (Section 4a). However, changes in the par value would be permissible, subject to the Fund's approval. Such changes "may be made only on the proposal of the member," and only in order "to correct a fundamental disequilibrium." Finally, they could be undertaken "only after consultation with the Fund" (Sections 5a and 5b).

Thus the Articles of Agreement established both the sanctity of a par value fixed to gold and an institutional mechanism for the alteration of that value. The key qualifying conditions were "fundamental disequilibrium," which was left undefined, and "consultation with the Fund." The Fund was left with the task of making its determination without much further guidance from the text of the Articles—merely the admonition that "the Fund shall concur in a proposed change....if it is satisfied that the change is necessary to correct a fundamental disequilibrium." However, the Fund was expressly forbidden to "object to a proposed change because of the domestic

[29] Nurske, p. 141.
[30] Nurske, p. 225.
[31] Nurske, p. 141.
[32] Nurske, p. 117. In addition, Nurske commented negatively on inter-war competition between financial centres, presaging Charles Kindleberger's (and later Stephen Krasner's) views on the desirability of a monetary and financial hegemon by some thirty years. See Kindleberger, *The World in Depression, 1929-1939*, Berkeley: University of California Press; Krasner, "State Power and the Structure of International Trade," *World Politics* 1976 (28): pp. 317-347.

social or political policies of the member proposing the change" (Section 5f). As for a proposed change in the external value of the national currency, the Fund's determination was to hinge on whether or not the disequilibrium occasioned by the existing exchange rate was likely to be self-correcting over the course of a normal economic cycle.

This formulation was consistent with the overarching commitment to national policy autonomy discussed previously. The state had emerged from the First World War with a greatly expanded range of activities, and a correspondingly expanded set of expectations on the part of its citizens regarding the delivery of safety and prosperity. In his early proposals for a reconstruction of the monetary order, Keynes had noted that these expectations—a "craving for social and personal *security*"—would only be multiplied after the conclusion of the Second World War,[33] and this analysis was widely shared. Thus the unsurprising verdict of the representatives of the mostly democratic governments assembled at Bretton Woods was that to the extent any trade-off exists, or is perceived to exist, between national prosperity and international market efficiency, national prosperity was to prevail. It was, after all, the government of Franklin D. Roosevelt that convened the conference, a man who had taken the dollar off gold in April 1933 and later proclaimed, during the proceedings of a World Economic Conference meeting, that "the sound internal economic system of a Nation is a greater factor in its well-being than the price of its currency in changing terms of the currencies of other nations."[34] The formula was clear: the welfare of individual states was not to be subjugated to the collective good of the international monetary system.[35]

Capital controls

The vagueness of the Articles of Agreement regarding the concept of fundamental disequilibrium has since been roundly criticised.[36] And indeed the absence of clear direction did give rise to numerous disputes, especially over the course of the 1960s and early 1970s, as to what constituted grounds for exchange-rate realignments. But these criticisms should be tempered by two considerations. First, the Articles constituted an international monetary constitution of sorts, an overall framework for international monetary relations. As befits a constitutional order (rather than the more exacting demands of legislation), the Articles refer to principles and to procedures, not to specific guidelines that were bound to be challenged by events. Surely any effort at precise formulation of what constituted fundamental disequilibrium, drawn up on the basis of the circumstances and thinking of the 1940s,

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[33] In Donald Moggridge, *Maynard Keynes: An Economist's Biography*, London: Routledge, 1992, p. 654; emphasis in original.

[34] Cited in James 1996, p. 24.

[35] Note, however, that the April 1942 draft version of the White Plan held that supermajorities of the Fund should be able to overturn any "monetary or banking or price measure or policy...the effect of which...would be to bring about sooner or later a serious disequilibrium in the balance of payments" (Horsefield 1969, p. 68). In short, White contemplated a degree of "multilateral sovereignty" (p. 40) that the rest of the US government was not prepared to endorse. This suggestion disappeared from the final (official) text of his proposals.

[36] For example, Cohen 1977, pp. 91, 185-187; Raymond F. Mikesell, "The Bretton Woods Debates: A Memoir," *Princeton Essays in International Finance 192*, Princeton, NJ: International Finance Section, Department of Economics, Princeton University, 1994.

would have looked archaic indeed by the time of the monetary crises of 1968-69, 1970-71, and 1972-3.

A second and even more important mitigating factor when considering the lack of specificity with respect to fundamental disequilibrium is that the exchange-rate provisions of Article IV were conceived in conjunction with the terms of Articles VI ("Capital Transfers") and VIII ("General Obligations of Members").[37] These Articles stipulated that states had the right to impose controls on capital movements, and that they could do so individually or co-operatively. Indeed, given the commitments to national policy autonomy and to exchange rate stability, a logical corollary was the shared understanding that international financial flows would have to be limited. The three-way trade-off between these values was well understood by the Bretton Woods negotiators, and the final agreement reflected their willingness to subordinate capital movements to the primary objectives of national autonomy and international stability.[38]

Indeed, speculative capital movements—"hot money"—played a central and wholly negative role in the League of Nations report. Nurske argued flexible currencies typically overshot their equilibrium values due to movements of speculative capital; furthermore, once stabilised at the wrong level there was no international mechanism for national authorities to undertake appropriate changes in a co-ordinated fashion.[39] The absence of adequate restrictions on such speculative capital movements had meant that, when "official controls stepped in to steady the exchange by one means or another" during the 1930s, the level at which they did so "was often reached in quite abnormal conditions."[40] Thus the competitive devaluations of the 1930s were driven, at least in large measure, by speculation.

In support of this contention Nurske quoted approvingly from Gottfried Haberler's 1937 warning that:

> *When...national policies cease to regard the maintenance of exchange stability as something which must take precedence over all other considerations...speculation regarding the probable movement of the exchanges, and capital movements in connection with such speculation, are normal and inevitable.*[41]

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[37] Helleiner 1994 provides an excellent overview of the capital controls debate and serves as an important corrective to the widespread notion in academic circles that the Bretton Woods agreements included a commitment to financial liberalisation. My analysis differs slightly from his, as indicated in the footnotes.

[38] For more recent formulations of the mutual incompatibility of capital mobility, policy autonomy, and exchange-rate stability, see Tomasso Padoa-Schioppa, "The European Monetary System: A Long-term View," in Francesco Giavazzi et al., eds., *The European Monetary System*, Cambridge: Cambridge University Press, 1988; and Benjamin J. Cohen, "The Triad and the Unholy Trinity: Lessons for the Pacific Region," in Richard Higgott, Richard Leaver, and John Ravenhill, eds., *Pacific Economic Relations in the 1990s*, Boulder, CO: Lynne Rienner, 1993.

[39] Nurske 1944, pp. 116-117.

[40] Nurske 1944, p. 123.

[41] Nurske 1944, p. 131, quoting Gottfried Haberler, *Prosperity and Depression: A Theoretical Analysis of Cyclical Movements*, London: George Allen and Unwin, 1956/1937, p. 431.

Of course, this passage admits of other interpretations, a subject to which we will return later.[42] But Nurske considered it supportive of his basic thesis that control of capital movements was necessary to reconcile national policy autonomy with exchange-rate stability.

...

On this point the chief British negotiator of the accord, John Maynard Keynes, and his American counterpart, Harry Dexter White, were in complete agreement.[43] As Keynes put it in 1942, "control of capital movements, both inward and outward, should be a permanent feature of the post-war system."[44] Elsewhere he made the more general case:

> *Freedom of capital movements is an essential part of the old* laissez-faire *system and assumes that it is right and desirable to have an equalisation of interest rates in all parts of the world...In my view the whole management of the domestic economy depends upon being free to have the appropriate rate of interest without reference to the rates prevailing elsewhere in the world. Capital control is a corollary to this.*[45]

White enthusiastically agreed:

> *A good case could be made for the thesis that a government should have the power to control the influx and efflux of capital, just as it has the authority to control the inflow and outflow of goods and of gold...It would constitute another restriction on the property rights of the 5 or 10 percent of persons in foreign countries who have enough wealth or income to keep or invest some of it abroad, but a restriction that presumably would be exercised in the interests of the people—at least so far as the government is competent to judge that interest.*[46]

The final Bretton Woods agreement largely reflected this consensus between White and Keynes on the subject of capital controls. Article VI provides that "members may exercise such controls as are necessary to regulate international capital movements," subject to the proviso that this right could not be exercised in a fashion that restricted payment on current transactions (i.e., trade). Thus after the conference Keynes triumphantly declared that "not merely as a feature of the transition, but as a permanent arrangement, the plan accords to every member government the explicit

[42] See Bordo and James 2001, esp. p. 12, 21-24.
[43] Eichengreen 1996, p. 96, 97-98, argues that "the White Plan...foresaw a world free of [capital] controls," but this is not at all correct.
[44] In Horsefield 1969, p. 13. This text was reproduced verbatim in the British White Paper of April 1943 (see Horsefield 1969, p. 31).
[45] In Donald Moggridge, ed., *The Collected Writings of J.M. Keynes, Volume 25: Activities, 1940-1944: Shaping the Post-War World, the Clearing Union*, Cambridge: Cambridge University Press, 1980, p. 149.
[46] In Horsefield 1969, p. 67.

right to control all capital movements. What used to be heresy is now endorsed as orthodox."[47] This assessment was only partly correct, however, as we shall see.

Convertibility and liquidity

The concentration of discretionary power over national monetary policy in national finance ministries suggested the possibility of abuse, even to representatives of those institutions. Both the American and British authorities wanted to break the authority of their central banks, but they did not want to rush into inflationary policies that would destabilise the monetary and trading systems they were so carefully constructing. But differences in the two states' financial positions, and hence their interests, made the discussion of discipline—via fixed exchange rates, convertible currencies, and limitations on the availability of external financing—the most contentious aspect of the Bretton Woods negotiations.

Convertibility and liquidity are probably best thought of in tandem. The willingness of governments—especially of governments likely to run payments deficits—to undertake commitments to convert their currency into valuable reserves, at fixed rates and upon popular demand, hinged very substantially on whether and how these governments could acquire additional reserves (official liquidity) in a crisis. Convertibility represented financial discipline, and in the absence of generally accepted alternative models of how discipline could be achieved—for example, by more recent notions of targeting inflation or the growth of monetary reserves—it was difficult to argue against some form of convertibility obligations. But the deflationary experience of the inter-war period cast a long shadow over the Bretton Woods negotiations, and over the calculations of both the British (who feared chronic payments problems in the war's wake) and the Americans (who were anxious not to underwrite the debts of either London or any other prospective deficit government).

The same concerns had preoccupied negotiators at the international monetary conference of 1922 in Genoa, Italy. The solution adopted there had been to "economise" on the use of gold reserves by permitting central banks to include foreign-exchange holdings in their reserve accounts. This departure from the practices of the classical gold standard was intended to break the link between expansion of the global gold supply (largely from South African and Russian mining operations) and international credit; hence the term "gold-exchange system" for the resulting monetary arrangements.[48] But as mentioned previously, the imbalance between the obligations of net creditors, who could hoard their payments surpluses, and net debtors, who had to choose between reducing demand in their economies or going "off gold," nevertheless resulted in a deflationary bias for the system as a whole. Some new arrangement needed to be devised.[49]

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[47] In Donald Moggridge, ed., *The Collected Writings of J.M. Keynes, Volume 26: Activities, 1941-1946: Shaping the Post-War World, Bretton Woods and Reparations*, Cambridge: Cambridge University Press, 1980, p. 17.
[48] On the gold-exchange system, see James 1996, pp. 18-19 (17-26); Cohen 1977, pp. 84-89.
[49] Note that the chapter in the League report concerned with exchange stabilisation funds was not authored by Nurske. See Bordo and James, p. 8.

Keynes's general vision called for a plan that "must operate not only to the general advantage but also to the individual advantage of each of the participants, and must not require a special economic or financial sacrifice from certain countries;"[50] "our British problem" of likely deficit status weighed heavily in his mind.[51] To begin with, Keynes argued that the Genoa formula of gold-plus-foreign-exchange earnings be counted as international reserves, to avoid reliance on "the technical progress of the gold industry" to determine overall reserve levels; to this the Americans readily agreed.[52] But Keynes' next proposal was far more controversial. He advocated the creation of an international money, the "bancor," as "an instrument of international currency having general acceptability between nations." In his view, this was the key to establishing a multilateral payments system, wherein "blocked balances and bilateral clearings are unnecessary" as each state would balance its books against the system, not individual trading partners. The overall volume of reserves would be "governed by the actual current requirements of world commerce, and is also capable of deliberate expansion and contraction to offset deflationary and inflationary tendencies in effective world demand."[53]

Moreover, Keynes envisioned a system of extensive balance-of-payments financing based on use of the bancor and the obligation of creditor governments to invest their surplus reserves abroad.:

> *We need a system possessed of an internal stabilising mechanism, by which pressure is exercised on any country whose balance of payments with the rest of the world is departing from equilibrium* in either direction, *so as to prevent movements which must create for its neighbours an equal but opposite want of balance...Measures would be necessary...to prevent the piling up of credit and debit balances without limit, and the system would have failed in the long run if it did not possess sufficient capacity for self-equilibrium to secure this.*[54]

To achieve this end, each member government would have a certain maximum limit, based on its overall volume of international trade, which neither its total "credit" or "debit" position with the new institution ought exceed. "In the case of debit balances this maximum has been made a rigid one, and, indeed, counter-measures[55] are called for long before the maximum is reached." But "in the case of credit balances no rigid maximum has been proposed." This, of course, required some explanation.

> *The absence of a rigid mechanism to credit balances does not impose on any member State, as might be supposed at first sight, an unlimited liability outside its own control. The liability of the creditor country is determined, not by the quotas for the other members, but by its own policy in controlling its favourable balance of payments...Thus the effect...is to give the creditor country a choice between voluntarily curtailing its exports...or, alternatively, of allowing its exports to continue and accumulating the excess receipts in the*

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[50] In Horsefield 1969, p. 20.
[51] See footnote 24.
[52] Although this apparent agreement was misleading, as I describe later in this text.
[53] In Horsefield 1969, pp. 20-21.
[54] In Horsefield 1969, pp. 20-21; emphasis in original.
[55] Author's note: this is now called conditionality.

form of bancor balances for the time being...If, therefore, a member State asks what governs the maximum liability which it incurs by entering the system, the answer is that this lies entirely within its own control.[56]

Not surprisingly, this answer did not satisfy the Americans. The two governments had radically different views on just what this new institution should do, as suggested by the rival names they had for it—Keynes' "Clearing Union" and White's "Stabilization Fund." Keynes had in mind "to generalise the essential principle of banking as it is exhibited within any closed system...If no credits can be removed outside the clearing system, but only transferred within it, the Union can never be in any difficulty as regards the honouring of cheques drawn upon it...Its sole task is to see to it that its members keep the rules and that the advances made to them are prudent and advisable for the Union as a whole." But it was precisely the capacity to draw funds out of the system—i.e., convertibility—that had obliged the members to "keep the rules" in the past, and the Americans were unwilling to abandon this safeguard.

In the end, White's team rejected the bancor scheme and turned to the matter of limiting their obligations for stabilising other countries' payments imbalances. When pressed, Keynes argued that—despite his earlier claims—the maximum liability of creditor states should indeed be the sum of all the other members' quotas. Under the terms of his scheme, this would cap American liability at $23 billion. White's team offered $2 billion. The eventually compromise reflected the relative negotiating power of the two sides: the US obligation was fixed at $2.75 billion, and the total of all quotas at $8.8 billion (as opposed to Keynes' proposal of $26 billion). It was a bitter disappointment for the British—and a decision that came back to haunt the United States during the 1960s, when suddenly it was the dollar that was under pressure. But White insisted that this was all that could be extracted from a sceptical Congress on the verge of switching from Democratic to Republican (and isolationist) control.

On the other hand, the paucity of official financing on offer probably helped tilt the exchange-rate negotiations in the British direction, towards greater flexibility for parities (the "fixed but adjustable" formula) and the inclusion of a "Scarce Currencies" clause.[57] And the Articles of Agreement provided for periodic reviews of quota assignments (Article III, Section 2). Finally, the Article XIV ("Transition Period") permitted members an extended derogation of their general obligations under Article VIII during the post-war period. That period was left undefined except in the form of admonitions that, "as soon as conditions permit," members "shall take all possible measures to develop such commercial and financial arrangements with other members as will facilitate international payments and the maintenance of exchange stability" (Section 2).

[56] In Horsefield, p. 26.

[57] Under the terms of Article VII ("Scarce Currencies"), the Fund could declare a currency to be scarce if it lacked sufficient holdings thereof, in which case it could authorise various measures aimed at increasing its holdings and permitting members to restrict payments in the scarce currency. Eichengreen 1996, p. 98, suggests that the dollar would be deemed scarce if, for example, US cumulative surpluses exceeded $2 billion and if the US contributions to the Fund had been exhausted in the service of other countries' deficits.

Bretton Woods: the negotiated agreement

These, then, were the central components of the Bretton Woods plan, as it was negotiated and understood by its founders: a system based on fixed but flexible exchange rates, extensive reliance on capital controls, and the subjugation of central banks at both the national and international levels. The plan called for the creation of a new, technical institution under the indirect control of national finance ministries as the central forum for discussing future monetary and financial policy issues. The currencies of participating governments would be fully convertible, after what was presumed to be a short transition period, and some—if not much—international liquidity would be available to deficit governments through the IMF.

But every element of this agreement soon came under pressure. The resources of the Fund were wholly inadequate to the task of post-war reconstruction, and so states refused to assume their Article VIII convertibility obligations. The United States first insisted that the war-torn European states and Japan maintain their exchange-rate parities based on the meagre official financing on offer. Then, when political circumstances changed with the emergence of the Cold War, Washington reversed itself and provided many times that level of support in the form of Marshall aid (announced in June 1947) while sanctioning a wholesale realignment of currency values (in September 1949). Just one year later Canada embarked on a floating exchange-rate experiment that soon had a small but growing corner of the academic community questioning the underlying utility of an international monetary system based on the principle of fixed rates. By then the planned abolition of the BIS had been scuppered as well.

All these developments took place within a half-dozen years of the Bretton Woods conference. Yet core elements of the Bretton Woods plan, at least as understood by Keynes and White, had been undermined even before the conference's conclusion. The most important of these were the negotiators' consensus on capital controls and the apparent understanding the two sides had shared on the definition of official reserve currencies.

The reserve currency controversy appears to have been the result of some deft parliamentary manoeuvring by White in his role as conference chair. Keynes had understood that the formula from the Genoa conference of 1922 would be replicated: namely, that central banks could count their foreign-exchange holdings—*all* their foreign-exchange holdings—together with their gold assets in computing their foreign reserves. He does not appear to have been informed, or even to have become aware, until the conference was nearly at an end that Article IV of the Fund's charter had granted the dollar a distinct status apart from all other national currencies.[58]

[58] Article IV, Section 1a holds that "the par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944." This was the pretext of Charles de Gaulle's later charge that the dollar enjoyed a "exorbitant privilege" in the Bretton Woods system, although of course the role that the dollar assumed in international monetary affairs had less to do with this formality than with the breadth and depth of the US financial system. For a discussion of how this phrase was inserted into the Articles, see James 1996, p. 50.

Even more important was the deterioration of the consensus between Keynes and While on the capital control regime. This should hardly be surprising; while a policy bias towards exchange-rate stability constituted a near universal consensus among contemporary academics, officials, and the representatives of private industry and finance, the issue of capital controls was deeply divisive. Strikingly, the division was not so much between the British and American negotiating teams—both of which shared the same overall orientation as the Nurske report—but within the US government. Both the US banking community and New York Federal Reserve Bank strongly opposed the position adopted by the Treasury Department early in the monetary negotiations, and eventually they succeeded in considerably diluting that position. The final result was a weak endorsement of capital controls—permitting but not encouraging their use, and removing all suggestion that such controls could be mandated by the Fund.[59]

Because the consensus on capital controls had been a critical component of the Bretton Woods "plan," meaning the shared vision of the conference's chief architects, any differences on that score between the plan and the final Articles of Agreement merit some extended attention. I begin by reviewing the early drafts of the Keynes and White Plans, and then comparing both to the terms of the formal agreement.

Capital controls: a bargain breaks down

Capital controls, as Keynes envisioned them, would be capable of distinguishing "long-term loans by creditor countries, which help to maintain equilibrium and develop the world's resources, from movements of funds out of debtor countries which lack the means to finance them." Controls would further distinguish, and provide means "of controlling short-term speculative movements or flights of currency whether out of debtor countries or from one creditor country to another."[60] To this end the British White Paper of April 1943 argued that capital "control, if it is to be effective, probably requires the machinery of exchange control for *all* transactions, even though a general permission is given to all remittances in respect of current trade." Noting that this blanket provision was unlikely to be well-received by "those countries which have for the time being no reason to fear, and may indeed welcome, outward capital movements," it added that given "a general permission of [long-term, productive] capital, as well as current, transactions," such exchange controls would be "reduce[d] to being no more than a machinery of record."

> *On the other hand, such control will be more difficult to work by unilateral action on the part of those countries which cannot afford to dispense with it, especially in the absence of a postal censorship, if movements of capital cannot be controlled* at both ends. *It would, therefore, be of great advantage if the United States, as well as the other members of the Clearing Union, would adopt machinery similar to that which the British Exchange Control has now gone a long way towards perfecting.*[61]

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[59] Compare Helleiner 1994, p. 25, who argues that "the agreement set up a rather restrictive financial order in which capital controls were not only permitted but encouraged" (p. 25). This suggests too wholesale an endorsement of Keynes' public pronouncements; the results of the Bretton Woods negotiations were in fact far more murky.

[60] In Horsefield 1969, p. 32 (from the official April 1943 White Paper).

[61] In Horsefield 1969, p. 31.

The British, in other words, strongly advocated a system of capital controls that would be both mandatory and co-operative. White went even further. In his Preliminary Draft Proposal of April 1942, White argued that, as a condition of membership in his proposed Stabilization Fund,

> *Each country agrees (a) not to accept or permit deposits or investments from any member country except with the permission of that country, and (b) to make available to the government of any member country at its request all property in form of deposits, investments, securities, of the nationals of member countries, under such terms and conditions as will not impose an unreasonable burden on the country of whom such a request is made.*[62]

In other words, White recommended that capital movements be subject to the approval of the sending state; that such approval be revocable; and that if permission was revoked the sending state (not the individual or firm) would be entitled to both demand and receive the transferred capital assets. Such draconian measures, White admitted, were "far-reaching and important." But their "acceptance would go a long way toward solving one of the very troublesome problems in international economic relations, and would remove one of the most potent disturbing factors of monetary stability," namely speculative capital movements and capital flight. "The search for speculative exchange gains or desire to evade the impact of new taxes or burdens of social legislation have been one of the chief causes of foreign exchange disturbances." Thus "it would seem to be an important step in the direction of world stability if a member government could obtain the full cooperation of other member governments in the control of capital flows." Such mandated cooperation "does not mean that capital flows between foreign countries would disappear or even greatly subside; it means only that they would not be permitted to operate against what the government deemed to be in the interests of any country."[63]

This was a dramatic proposal, and evoked immediate and equally dramatic objections. These objections were generally of two kinds: practical and principled. The practical objections centred on the argument that it would be difficult, if not impossible, to distinguish between "productive" and "speculative" capital movements, or for that matter even to separate out those transactions aimed at financing trade (which even Keynes and White regarded as the central purpose for reconstructing a genuinely international monetary system).[64] Thus Keynes' proposals were, on this view, unworkable. The principled objections were equally vehement. It was one thing to suggest that the policies of the state should not be hostage to international markets; it was another thing to suggest that the financial interests of individuals and firms should be hostage to the state (or even to foreign states). Both these arguments had considerable traction in the United States, and even within the Roosevelt

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[62] In Horsefield 1969, p. 66. This text is from the April 1942 draft. The July 1943 publication adopts substantively the same position, but with somewhat clearer language; see Horsefield 1969, p. 96.
[63] In Horsefield 1969, pp. 66-67.
[64] Along similar lines, economists continue to distinguish between "autonomous" and "accommodating" transactions, but this is a theoretical distinction with no counterpart in any actual national accounting system. See the discussion in Cohen 1977, pp. 20-24.

administration—particularly following Republican gains in the 1942 congressional elections.[65]

Meanwhile the British team was re-evaluating a passage in the White Plan decrying the use of "foreign exchange restrictions, bilateral clearing arrangements, multiple currency devices, and discriminatory foreign exchange practices *as hamper world trade and the international flow of productive capital.*"[66] Keynes had of course originally argued that the system for post-war capital controls should be able to make distinctions of precisely this sort (that is, between "productive" and "speculative" capital movements). But the British government, backed by the Bank of England, had since come to fear—no doubt on the basis of the arguments being advanced by American banking interests—that in fact such distinctions would become virtually impossible, and that therefore the "productive capital" clause might invalidate provisions elsewhere in the agreement authorising capital controls of any kind.[67]

Capital controls in the Articles of Agreement

In the end, the Bretton Woods agreement represented a compromise of sorts—a fudge, if you will—on the whole issue of capital controls. In deference to British objections, the Articles make no reference to "productive capital" or to its promotion as an objective of the Fund. But likewise the passages concerning capital controls are very weak compared with those of either the Keynes or the White Plans. Article VI ("Capital Transfers") states that "members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments" (Section 3).[68] Any suggestion that co-operative controls would be mandatory had been deleted. Indeed, Article VI makes no reference to co-operative controls whatsoever, and the only hint of mandated controls concerned prohibitions of the "net use of the Fund's resources to meet a large or sustained outflow of capital" (in which case "the Fund may request a member to exercise controls to prevent" such usage of its resources).[69] Article VIII ("General Obligations of Members") does make reference to co-operative controls, but purely in a permissive sense; such co-operation is neither mandated nor even encouraged. Instead, "members may, by mutual accord, co-operate in measures for the purpose of making the exchange control regulations of either member more effective," but even this weak authorisation is subject to the proviso that "such measures [must be] consistent with this Agreement" and explicit

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[65] For a summary of the objections of the New York banking community to White's proposals and the Roosevelt administration's response, see Helleiner 1994, pp. 39-49.

[66] In Horsefield 1969, p. 86, emphasis added. This text is from the official (July 1943) version of the White Plan; but promoting "flow of productive capital" had also been featured as a central purpose of the Stabilization Fund in the original (April 1942) White Plan (see Horsefield, p. 46). Compare in this regard Helleiner's discussion of the topic (1994, pp. 44-45).

[67] Evidently the British did not come to this conclusion until early 1944, some two years after the phrase had been mooted in White's draft proposal (again, compare Helleiner 1994, pp. 44-45).

[68] The Section includes exceptions relating to the "scarce currencies" clause of Article VII.

[69] Article VI, Section 1a. This too was a diminution of the Fund's right, in previous drafts, to "require" rather than merely request such measures.

reiteration of the prohibition of "restrictions on the making of payments and transfers for current international transactions" (Sections 2a and 2b).[70]

This was hardly the strong system of capital controls that the British had consistently sought, and that the US Treasury team had initially endorsed. But it was the shape of things to come. Indeed, at a press conference held during the conference, White was obliged to declare that while other countries were at liberty to impose capital controls, "the United States does not wish to have them."[71] In view of this, Keynes' post-conference declaration that "what was once heresy is now orthodox" sounds more like spin control than factual description. In point of fact, the final text of the Bretton Woods agreements frames its support for capital controls in a considerably more muted fashion.

The failure to endorse a comprehensive scheme for controlling capital movements, in conjunction with the limited resources of the IMF, combined to make the Fund almost irrelevant in the immediate post-war period.[72] European recovery, as Milward reminds us, required offsetting capital inflows to balance the continent's demand for everything from industrial equipment to consumer goods. But in an environment of fixed rates, limited official liquidity, and ineffective capital controls, capital flowed in the opposite direction—away from war-torn Europe and towards the safe haven of New York. In the absence of the Marshall Plan, it is not clear that the commitment to fixed rates would have survived the end of the decade. Even with Marshall aid, a massive realignment was necessary to relieve some of the pressures on European currencies.

Indeed, it required a combination of Marshall aid, a tightening of capital controls, the September 1949 devaluations, continued inconvertibility, and later the multilateral payments scheme of the European Payments Union to stabilise the continent's currencies. Thus post-war international monetary practice shifted from violating the capital controls regime of the original Bretton Woods plan to violating its liquidity and convertibility provisions while weakening its commitment to exchange-rate stability. Small wonder, then, that so many scholars choose to regard the post-1958 shift to European currency convertibility as marking the start of the "classical" Bretton Woods system,[73] despite the fact that this period too fails to correspond to the terms of the plan.

[70] The only power provided to the Fund in Article VIII to mandate action regarding capital movements concerned the provision of information, not the imposition of controls. Thus "the Fund may require members to furnish it with such information as it deems necessary for its operations, including...national data on...known capital transfers." But even this provision was limited by the proviso that "members shall be under no obligation to furnish information in such detail that the affairs of individuals or corporations are disclosed" (Sections 5a and 5b).
[71] In Armand van Dormael, *Bretton Woods: Birth of a Monetary System*, London: Macmillan, 1978, p. 185.
[72] This the League report had clearly foreseen: "If, in addition to trade and other normal transactions, such a fund had to cover all kinds of capital flight, it might have to be endowed with enormous resources. In fact, no fund of any practicable size might be sufficient to offset mass movements of nervous flight capital." Nurske 1944, p. 188.
[73] The term is Gilpin's (1987, p. 134); see also Keohane and Nye 1977, p. 74.

The Myth of Bretton Woods

As we have seen, the Bretton Woods "system" was a myth in both the large and small senses of the term. In factual terms, there never was an international economic system that corresponded to the actual terms of the agreement, and serious efforts to enforce those terms—to bring the system as initially designed into being—were quickly abandoned, and in fact long before the summer of 1947. At the same time, the Bretton Woods experiment was remarkably successful in achieving its core objective: the establishment of an international monetary order consistent with national policy autonomy and massive trade expansion. Other, subsidiary objectives—the permanent taming of financial markets, the use of exchange-rate pegging to discipline the economic policies of the system's key members, and especially the subjugation of central banks—were all eventually abandoned. Some of these changes occurred almost immediately after the system's creation, others later. But the twin aims underlying the system, trade growth and policy autonomy, continued to be satisfied even after the rules of the game had been substantially discarded.

That the terms of the "system" proved to be so pliable in practice should not really be surprising. More surprising indeed would have been a plan developed at the height of the Second World War that actually accommodated the economic circumstances of the next quarter century. Instead, there were enough discrepancies in the agreement to allow for difference of subsequent interpretation. Indeed, as we have seen there were even serious discrepancies between those elements of a "plan" shared by both the chief Bretton Woods chief architects and the text of the agreement ultimately endorsed by their governments in 1944.

By the 1960s, most of the central elements of the original Bretton Woods understanding had been abandoned. With the exception of the continuing commitment to pegged exchange rates, the resulting system no longer resembled the original pact in any substantial way. International monetary co-operation operated according to the rules of a new system, based on agreements made in Basel, not New Hampshire, and on collaboration among central bankers, not finance ministries and the International Monetary Fund. The emergence of this new system depended in the first instance on the shortcomings of the old, as described in this paper. It further depended on the sometimes ingenious proposals of central banks in Europe and America to amend those shortcomings, a story that awaits another telling.