

Hegemony War In Bretton Woods: John Magnard Keynes And Harry Dexter White

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Abstract

Countries were obliged to cooperate since financial structure, which had become unsteady by two world wars and Great Depression, was reestablished. For this purpose, Bretton Woods Conference hosted by the USA was conducted by the participation of 44 countries in 1944 which it is called as new order building. Bretton Woods's System demanded requirements of a period and it contributed development of Japan, Germany and many European countries during the period until it lost validity. Effects of Bretton Woods's System have continued by IMF and WB which it was decided they were established by the conference and have been in the position of implementing neoliberal policies in our day. For this reason, purpose of this study is to review Bretton Woods's System shaping capitalism of 20th and 21st century and compare two plans emphasized in the conference. Firstly, process designing Bretton Woods's System is involved through payments system and then conceptual framework of the system is examined.

Keywords: Bretton Woods, , Keynes Plan, White Plan. JEL Classification: B1, E42, E12, B19.

Introduction

While use of the currency through exchange function dates back to very old times, history of the applied international money systems can be considered relatively newer. In this direction, international financial system can be examined historically in four periods. Respectively, Gold Standard applied in 1970 to 1930, Great Depression period in 1930 to 1944, Bretton Woods's period in 1944 to 1973 and combined period that has continued until today upon the system collapsed in 1973.

Bretton Woods's System of the international currency systems takes place in economics field in many respects due to socio-economic returns of the system. System played active role to meet needs of one period and it made contributions by 4-5% growth rates which weren't seen before in economic history. Although it lost validity in 1973, institutions that were founded by Bretton Woods and have applied neoliberal policies have been still efficient.

For this reason, it is aimed in the study to examine Bretton Woods's System which contributed to structure economic order over the recent two centuries. In the study, firstly we examine elements that has required establishment of Bretton Woods's system. It is aimed to comprehend conditions under which the system has been established by reflecting chart of economic outlook of that period. After that, rules of the system are explained in detail and it is tried to answer the question "why did system collapse?"

1. Process of Transition from Gold Standard System to Bretton Woods's System

Monetary system applied from 1870s to World War I is Gold Standard System in which value in national currency of every country is specified against gold and the currency is fixed to a shared value (Eichengreen, 1996: 3). However, Gold Standard was abandoned upon World War I took place and rates were left to free float. Effort to turn back the same system for the second time after the war didn't produce successful results because of restrictions in commercial and payments system applied in war economy (Cömert, 2016: 119).

Countries sought for an order again in payments system after World War I faced with Great Depression of 1929. It is the crisis that is known as Great Depression (great depression or black Thursday) in economic literature and took place on international scale in 1929 to 1944 and for which classical economic thought remained incapable (Eichengreen, 1996: 12; Fields, 2010: 11). After Great Depression, unemployment increased all around the world and national income of the country regressed considerably (Nere, 1980). When considering in terms of international payments system, it became difficult to turn back Gold Standard System since countries employed applications for trade restrictions as a precautionary measure.

World War II that took place after Great Depression affected socio-economic order in international field changed balance of power. While Britain that was the most important power of the period before World War II lost its colonial administration on Africa, Pacific and Mediterranean, other countries which financed war expenditures by issuing money faced with high inflation (Engdahl, 2008: p.121-122). In spite of that, the USA overcame World War II with a little damage and could increase gold reserves up to 2.85 million dollars which it has been 1.57 million dollars before the war (Federal Reserve Bulletin, 1989: 425).

Countries were obliged to cooperate since the structure that became unsteady for international trade and payments system reduced the world welfare. However, the USA, which gained power within the changing balance at that point, planned to help indirectly other countries destroyed by the war instead of helping directly. In order to configure international economic cooperation and new international monetary order, it was decided to conduct a conference characterized as "construction of a new order". Conference was conducted by the participation of representatives from 44 countries in Bretton Woods, New Hampshire state, the USA, 1 to 22 July of 1944 (Boughton and Lateef, 1995).

2. Plans Discussed in Bretton Woods

Two proposals were discussed in the conference which they had been prepared and issued as draft by two competitor countries, Britain and the USA, in 1943 (Thirlwall, 1976: 13). The first plan was prepared by John Maynard Keynes on behalf of Britain. The second plan was prepared by Harry Dexter White on behalf of the USA and proposed by Morgenthau, Undersecretary of the Treasury. Proposals that are basically similar to each other are explained in detail in the next section.

2.1. Keynes Plan

Within limited scope, plan that protects interests of Britain seriously destroyed by World War II is characterized as more democratic by the economists through the proposal eliminating pressure of the political circles in wide range. Proposals predicted to apply in Keynes Plan are presented respectively:

It was aimed at the heart of Keynes Plan to establish a central bank (International Clearing Union-ICU) called as bancor at international status. In the system, nominal value of bancor is fixed with the gold and value of every national currency is determined in terms of bank (Steil, 2013: 143-144). Central bank of every member country continues to keep account with ICU in order to keep the balance with other countries (Bordo and Eichengreen, 2007: 32).

Country accessible in payments balance can be balanced by withdrawing money from the system at interest; as for the country having payments surplus, it can keep the balance through the interest earned. Therefore, liability can be met by the surplus country (Boratav, 2016: 29).

- A quote is set for each member country in order to determine the limit over resources to use between 25 and 30 million US dollars (Bordo, 1993: 32-33). In the plan, rules are predicted to regulate quotes for both debtor and creditor parties. Creditors take some precautions such as expansionary internal loan, evaluation of currencies, interruption of the duties and enlargement of international development credits.
- Another important feature of the plan is to ensure capital controls in order to prevent speculation generated at fixed rate against the market.
- Establishment of IMF and WB known as Washington consensus is one of the important predictions for the plan. However, since Keynes thought that institutions would be affected by political circles in case they were established establishment in Washington, he suggested establishing them in New York (Öztürk, 2002: 99).

2.2. White Plan against Keynes

System that contains different opinions and is more complex compared to Keynes Plan was the plan that had been accepted predominantly and put into practice after the conference due to predominant status of the USA at that period (Wherry and Schor, 2015: 251; Kuruç, 2016: 10). White Plan predicts a fixed exchange rate system that is built over US dollar and prevents convertibility of dollar to gold in the system. Main lines of the plan are respectively;

- In the plan, currency is determined by the unit called as unit at first and then as unitas that depends on a stable gold parity and 1 unitas unit corresponds to 10 US dollars (Mikesell, 1994: 10; Bordo, 1993: 33). Every country accepts 1 unitas as 10 US dollars and price of 1 Ounce gold is designated as 35 dollars (Stobbs, 1946: 37). Central Bank undertakes to convert dollar into gold upon the request of central banks of other countries.
- United Nations Stabilization Fund of which establishment was planned in White's Plan constitutes the most important part of the plan (Bordo, 1993: 33). For the Fund to which every member country will contribute by a specified quota, it has been planned to interchange with currency of another country involved in the Fund for a country having disturbances with payments balance, instead of collecting it as predicted in Keynes Plan. The country used resources from the fund can pay back by a domestic currency approved by the Fund.

3. Conceptual Framework of Bretton Woods's System

Proposal predominantly predicted by White Plan were put into practice in the conference gathered to reestablish financial order of the World. Bretton Woods's system based on adjustable fixed exchange rate system and formal capital movement is also known as IMF system in economics literature (Seyidoğlu, 2003: 144).

It was decided by the system to establish International Money Fund-IMF International Bank for Reconstruction and Development- IBRD or WB) which are two important financial institutions. IMF founded to provide loan for member countries having deficits in payments system was put into practice in 1945 (Boughton, 1997). As for IBRD, it was put into practice in 1947 in order to provide reconstruction

for the countries that had weaker economies after the world wars (Çeştepe and Genç, 2011: 56). Furthermore, outline of the system, decisions made in the conference and deficiencies in the system are discussed in detail in next section.

3.1. Rules of Bretton Woods's System

The system predominantly accepted over the plans discussed during the conference has been the plan prepared by White on behalf of the USA. Moreover, rules applied in the system are as the following:

- **Stabilization in Exchange Rate:** In the system based on fixed exchange rate, currencies of the member countries are accepted depending on dollar. In the system, dollar is indexed to gold and 1 ounce gold (31 gr) is accepted as equal to 35 US Dollars (Stobbs, 1946: 37). Full convertibility is applied between gold and dollar. Fluctuation of currency is accepted with $\pm 1\%$ margin.
- **Elimination of Exchange Control and Import Restrictions:** As mentioned before, GATT was planned to be founded in order to eliminate liberty of trade restricted under the conditions of war economy during two world wars and it was put into practice in 1948, and extensive concessions were included between the countries.
- **Assurance of International Liquidity:** Success of the economies applying fixed exchange rate system without restrictive applications depends on sufficient liquidity (Bordo, 1993: 32). For this reason, it has been decided to assign quota to every member country of IMF in proportion to domestic economic volume in order to supply sufficient amount of international liquidity in Bretton Woods's System.

3.2. Deficiencies in Bretton Woods's System

Bretton Woods's System that had made considerable contribution to world economy accelerated movements of globalization and it remained in force for the first thirty years (Davidson, 2017: 148). However, troubles appeared in the system after the commencement of Vietnam War and the increasing reform expenditures in the USA late in 1960's. At the first quarter of 1973, system lost validity after the developed countries left their currencies to flexible exchange rate.

However, a clear consensus was not arrived between the reasons which caused subversion of Bretton Woods's System. Some failures of the system emphasized in economics literature are differences between the USA and foreign currency policy, differences between the USA and external financial policies, failure of the countries in devaluation which had a deficit in payments balance, failure of the countries in revaluation which had a surplus in payments balance and Triffin Dilemma (Eichengreen, 1993: 624). If we collect factors accelerating the process under headings (Öztürk, 2002: 103-104):

- **Adjustment (Balance) Problem:** Adjustment in system is left to decisions of the country owing to the fact that the system has no automatic adjustment mechanism. In currency adjustments, devaluation is predicted for the countries having an external deficit as a solution but there isn't any precaution of revaluation for the counties having external surplus. For this reason, contrary to what Keynes predicted in his plan, only one of the parties was blamed for disequilibrium of the payments system (Boratav, 2016: 29).
- **Seignorage Problem:** US Dollar has been regarded as key currency in the economy as dollar is instrument of payment, responder tool and reserve currency in international status. As a result of this situation, the USA return on Seignorage that derives from issuing dollar is considered as a problem by other countries. De Gaulle, the French President, expressed the first reaction between the countries

involved in the system (Scott-Smith and Rofe, 2017: 83). After that, other member countries frequently criticized this situation.

- **Triffin Dilemma (Confidence-Liquidity Problem):** Success of fixed exchange rate system without restrictive applications depends on the presence of sufficient liquidity. As for the liquidity problem emerging in Bretton Woods's System, the reason was that liquidity resources were not sufficient or reliable to finance development of output and trade (Bordo, 1993: 51; Eichengreen, 1993: 622). Dependence of the system on limited gold reserves and US dollars caused a problem which examines sustainability of this system. It was required to meet the liquidity with dollar as the gold is limited and external deficits thus increased in the USA. In case external deficit can't be met, a crisis of confidence is caused by the idea, which was proposed by the system, that commitment to convert dollar into gold could not be realized. This situation is the hypothesis developed by the economist Robert Triffin (1978) which it is also known as Triffin Dilemma in the literature. System remains unprotected against speculative attacks upon the doubt of sustainability about the system.
- **Problem of Skipping the Underdeveloped Countries:** It contributed to development of Japan, Germany and many European countries by high economic growth rate (Bordo and Eichengreen, 2007: 78). However, policies applied for liberty of trade conflicted with the economic reality of underdeveloped countries and thus their current financial conditions had become much worse (Kuruç, 2016: 19). In addition, applications of IMF have changed over the time which it was founded in order to supply credit support for the countries having troubles in payments balance. It is frequently discussed in the economics literature that IMF gives orders under the conditional support for undeveloped countries in the periods of economic depression.

Conclusion

World War I, Great Depression and World War II took place one after another in history of economics caused disruption of world's financial system to a large extent and subversion of the economy. After that period, unemployment increased all around the world and economic growth rates decreased considerably and financial system collapsed. Countries had to work in cooperation as the financial order that became unsteady and disrupted was structured as well as a new monetary system. For this purpose, Bretton Woods Conference hosted by the USA, which was superior power of that period, was conducted by the participation from 44 countries. Two different plans prepared by the USA and Britain looking after interests of the USA and Britain were discussed in the conference. White Plan predominantly represented the USA was put into practice at the end of conference. In conclusion, Bretton Woods's System remained valid for 30 years as from it had been put into practice and it made important contributions to world economy. Although the applied monetary system was abandoned, financial structures founded by Bretton Woods have been keeping its efficiency in our day. Besides, Bretton Woods's System plays an important role in shaping today's balances of power.

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