

## II AN UPDATED BRETTON WOODS?

A widely held view on the background and rationale of reform is that the international monetary system designed at Bretton Woods at the end of World War II served the world well for the first postwar generation, but that a new system is now required to cope with the changed requirements of the 1970s and beyond. It follows from this approach that the amendments required in the new system should be based on the evolving changes that have taken place in the structure of the world economy. The most important of these changes has been the diffusion of economic strength among at least the major countries, with a corresponding decline in the relative economic strength of the United States. This in turn has entailed a need for the United States itself to initiate adjustment in its own competitive position, thereby creating a need for a truly universal world payments mechanism to replace the system in which the United States was not merely passive but lent its great strength to accommodate the adjustments needed by other economies.

This view of the problem reflects the undoubted change that has taken place in the balance of global economic power. But in its historical retrospect this view is misleading in a way that has the effect of understating the extent of the adaptive adjustments that are now required to fit contemporary circumstances. In fact, the international monetary system as laid down in the Articles of the IMF has never been in full operation. For the first decade and more after World War II, all but a handful of countries maintained inconvertible currencies and made extensive use of restrictions on current trade and payments. After a brief period in the late 1950s in which the shifting balance of economic power between the United States and the other main trading countries produced a moment of equilibrium in the exchange markets, the monetary system entered the trials of the 1960s. In this period, significant adjustments in payments positions were again called for, but willingness to adjust the exchange rate was resisted for many years by each of the major economies in fundamental disequilibrium – Germany, the United Kingdom, Japan and the United States itself. These long delays in exchange adjustment involved a series of derogations from the spirit and ultimately the letter of the IMF Articles, culminating in the currency realignment of August-December 1971 which brought the system down with it.

The fact that the system of the IMF Articles was never fully in place in the first quarter century after World War II, a period of exceptional economic success for the world economy, must not be seen in denigration of the Bretton Woods agreement and what flowed from it. For it is now possible to see that the true significance of that agreement was the commitment it embodied among national authorities to concede at least that minimum degree of international cooperation as appeared necessary to further broad national interests that manifestly

required collective action; and above all, to check any backsliding and retrogressions safely before the point at which they threatened to set off a self-aggravating chain of mutual damage. This important negative achievement underlay the series of expedients and ad hoc responses of monetary authorities to the pressures that developed from 1960 onward. In this categorisation must be included the negotiation of the SDR facility itself, representing a major response to only a part of an inter-locked problem. The recognition by major governments and financial authorities of their common interest in avoiding a mutually destructive *sauve qui peut* remains an important safeguard for the health of the world economy.

But just as this achievement of Bretton Woods takes on growing stature with the passage of time, in which the contrast with the sorry experience of interwar years grows the more impressive, so the perspective of time illuminates the instrumental inadequacy of the original Articles – which were themselves, of course, the result of major compromise – to implement the broad objectives then laid down.

Thus the wise objective of stable but adjustable exchange *rates* did not find reflection in a mechanism that could be relied on to implement it. The chosen regime of periodically adjustable *parities* manifestly failed to do so. Parities for each currency were set in terms of gold (and latterly SDRs) with provision for limited variation in exchange rates within prescribed narrow margins around the parity. In addition, exchange rates could vary as a result of adjustments in a country's own parity, and in the parity of other countries. Thus stability in a country's own parity did not provide stability in its effective exchange rate, and the abrupt nature of adjustments in parities created instability in movements in exchange rates over time. As a result, exchange rates have been in turn either stable but rigid, or flexible but unstable. This mechanistic inadequacy has still not been fully confronted in official discussion, and the same inadequacy threatens to carry over into the new system.

The Bretton Woods objective of strengthening the base of international liquidity and initiating a degree of administered control over such liquidity marked a major step forward, which was carried further with the establishment of the SDR facility in 1969. But these innovations were limited to the provision of new facilities. Their impact was overwhelmed by variations in reserves in the form of foreign exchange, including balances held in new, appreciating reserve currencies and in Euro-currency markets. Only minimal regulation has been applied to this sector of reserve holdings, and as a result, the role of reserve currencies has increased, rather than diminishing in line with official intentions. These inadequacies in control over international liquidity are now better understood. But there remains a marked reluctance among many individual countries to accept the restraints and disciplines that establishment of effective control over the world reserve system would require.