Chapter 6

American hegemony and the evolution of the international monetary system after 1945

6.1 Introduction

The indisputable dominance of the United States after 1945 and its role in the revival of economic interdependence and prosperity in the industrialised world provides the theory of hegemonic stability with its most enticing example. While the preceding chapters have argued that the theory encounters problems when applied to the pre-World War II era, it can be argued that 'American hegemony, rather than being one more instance of a general phenomenon, was essentially unique in the scope and efficacy of the instruments at the disposal of a hegemonic state and in the degree of success attained.'[1] This chapter attempts to give a broad analysis of the claims made for American hegemony after 1945 with respect to its role in the so-called 'Bretton Woods' system.

For some, the primary function of the US after the war was establishing and maintaining the rules and institutions of a 'liberal' world economy.[2] The view is commonly expressed that US dominance was crucial for the establishment and maintenance of the Bretton Woods regime, and that US decline was equally crucial in its subsequent downfall.[3] We will therefore need to examine the role which the US played in the establishment of the postwar international monetary system.

Most commentators would argue that the American role went well beyond one of rule-enforcement, to include that of the active management of the Bretton Woods international monetary system. As

Calleo writes: '[It] is widely accepted that the United States has acted since World War II as a kind of world central bank, creating by its deficits the additional credit necessary to service an expanding world economy.'[4] Not surprisingly, with US hegemony seen as crucial in stabilising the international monetary system, the consequences of US decline for international monetary order have typically been seen as overwhelmingly negative. On the one hand this is meant to have led to increasing American unwillingness to bear the costs of the provision of these international public goods, and on the other a growing inability to do so as the forces of foreign economic nationalism steadily eroded relative US dominance.[5] By the mid-1980s, the notion that the relative decline of American economic power entailed growing conflict in the world economy was widespread in academic, journalistic and even policy-making circles. The Bretton Woods system, a product of US hegemony, was the first casualty of the end of the American Century.

6.2 American dominance and wartime planning

The international political, economic and financial consequences of World War II were in many ways similar to those of the 1914–18 war, but altogether more far-reaching. At the height of the conflict, in Paul Kennedy's words:

> Former Great Powers – France, Italy – were already eclipsed. The German bid for mastery in Europe was collapsing, as was Japan's bid in the Far East and Pacific. Britain, despite Churchill, was fading. The bipolar world, forecast so often in the nineteenth and early twentieth centuries, had at last arrived . . . and of the two [superpowers], the American . . . was vastly superior.[6]

The extraordinary superiority of the US in the depths of the global conflict could be demonstrated in virtually every variable of power one could think of. It had long possessed a marked advantage in labour productivity, underlining the organisational and technological basis of its dominance (table 6.1). In terms of sheer size, the US economy dwarfed the others in a way in which Britain's had never done (table 6.2). America had become the workshop of the Allied war effort and the demand for its food and capital goods would remain strong after the war. All in all, the US was the only major economy to have benefited from the war, its real output having doubled, its goods having captured important new overseas markets, its merchant fleet unrivalled, and its gold reserves having grown to two-thirds of the world total.

Planning of the shape of the postwar international monetary system

Table 6.1 Labour productivity (GDP per hour worked), major countries, 1870–1984 ($US at 1984 PPPs).

Year	France	Germany	Japan	Neth.	UK	US
1870	1.05	1.13	0.37	2.02	2.13	1.95
1890	1.42	1.63	0.53	n.a.	2.82	3.02
1913	2.21	2.50	0.81	3.35	3.59	4.58
1929	3.21	3.11	1.42	4.96	4.52	6.73
1938	4.14	3.85	1.77	4.91	4.91	7.12
1950	4.54	3.67	1.52	6.17	6.41	11.14
1960	6.95	7.13	2.70	8.62	8.04	14.44
1973	14.31	13.94	8.39	16.77	13.91	19.29
1984	20.78	19.28	11.85	20.72	17.17	21.12

Source: Maddison, 1987, table A-5, p. 683.

began during the War, and there is little doubt that US economic and financial power played a major role in the outcome. It would be wrong, however, to overlook the role of Britain, despite the large discrepancy in the relative strength of the two powers. What was unprecedented was the direct presence of the US in the negotiations and the fact that the other major industrial countries, which were either enemies of the US and Britain or under enemy occupation, played virtually no role.

An important factor in the outcome which was not reducible to relative power positions was the role of a relatively small number of internationally-minded experts (the most famous of these being Keynes and Harry Dexter White). In many ways these experts had more in common with each other than with powerful political currents in their own countries.[8] Keynes' overriding concern to banish the 'deflationary bias' of the international gold standard was largely shared by the US Treasury negotiating team under White, whose aim 'was not to restore a regime of private enterprise but to create a climate of world expansion consistent with the social and economic objectives of the New Deal.'[9] In principle, then, both were agreed that a key objective of international monetary reform would be to prevent external payments imbalances from precipitating a deflationary spiral of the kind witnessed in the Depression years. This was consistent with the fundamental shift in the balance between state and economy which had occurred since the late nineteenth century in most advanced countries and which was accelerated by the war.

Even so, there were major differences between the Keynes and White plans for international monetary reconstruction. In part, these inevitably reflected the national interests of the countries they

Table 6.2 Economic and financial comparisons of major industrial economies, 1950–85.

	Country	1950	1955	1960	1965	1970	1975	1980	1985
1. Ratio to US GDP[a]	US	1.00		1.00			1.00[d]		1.00[e]
	Germany	0.14		0.22			0.23		0.22
	Japan	0.10		0.16			0.33		0.40
	UK	0.22		0.21			0.19		0.17
	France	0.14		0.15			0.19		0.19
2. Shares world exports[f]	US	17	18	17	16	15	13		12
	Germany	3	7	10	11	12	11		10
	Japan	1	2	3	5	7	7		7
	UK	11	10	9	9	7	5		6
	France	5	6	6	6	6	6		6
3. Shares world imports[f]	US	16	14	13	13	14	13	13	19
	Germany	4	6	8	10	10	9	10	8
	Japan	2	3	4	5	6	7	7	7
	UK	12	12	10	9	7	6	6	6
	France	5	5	5	6	6	7	7	6
4. Shares world reserves (−gold)[b]	US	10	6	7	5	6	2	4	7
	Germany	1	11	18	10	17	14	12	10
	Japan	4	6	8	6	8	6	6	6
	UK	4	2	4	2	3	2	5	3
	France	1	6	3	6	2	4	7	6
5. Shares world gold[c] reserves	US	68	62	47	34	30	27	28	28
	Germany	—	3	8	11	11	12	10	10
	Japan	—	—	1	1	1	2	3	3
	UK	9	6	7	5	4	2	2	2
	France	2	3	4	11	10	10	9	9

Notes: [a] $US at 1984 PPP. [b] SDR millions. [c] Million oz. [d] 1973. [e] 1984. [f] IMF, 1988 (Current Exchange Rates).

Sources: 1. Maddison, 1987, table A-1, p. 682. 2, 4, and 5. IMF, *International Financial Statistics*. 3. IMF, 1982; United Nations, 1987, p. 22.

represented. The continued growth of US gold stocks during the war years encouraged American financial élites to continue to look with favour upon the idea of a full restoration of the international gold standard.[10] Such views carried sufficient weight with the economic nationalists in Congress to rule out the adoption of early versions of the Keynes and White plans, both of which envisaged a considerable degree of supranational control over international capital flows and liquidity, as well as exchange rates and national macroeconomic policies. The unacceptability of Keynes' supranational Clearing Union to the US Congress had much to do with the fact that the US would be the major creditor country after the war. This ensured that a much less radical American plan, based upon a Fund made up of member state contributions of gold and foreign exchange, became the basis of the Bretton Woods agreements.[11]

Both the American and British Treasury teams had sufficient political support to resist pressure from financial circles for a return to the gold standard. This enabled Britain to gain some important concessions which were to make Bretton Woods a compromise rather than a *Diktat*. This is most apparent on the question of adjustment responsibilities between countries. Britain feared that without adequate safeguards in terms of placing symmetrical pressure on both surplus and deficit states to adjust to imbalances, the prospect of postwar recession in the US might jeopardise Britain's ability to maintain full employment without resorting to direct trade and exchange controls. The Americans made three concessions to British fears.

The first of these was the famous 'scarce currency clause', which justified the Fund's rationing of a currency in short supply as well as restrictions by other countries of transactions in that currency. Whether this concession would prove significant or not was difficult to tell, since much would depend upon whether the Fund was allowed to undertake sufficient lending in a particular currency for a shortage to develop.[12] Second, the Americans agreed to increase the Fund's resources from the $5 billion initially envisaged to $8.8 billion, their own contribution constituting about 35 per cent of this figure. The US was unwilling, however, to accede to the British idea that quota contributions be unconditionally available for short-term financing needs. Keynes therefore pushed the Americans to give way on their firm opposition to the idea that exchange rate changes should be a matter of national policy sovereignty, rather than requiring permission from the Fund.[13]

In what was a major concession, the US accepted automatic Fund concurrence in exchange rate changes of less than 10 per cent and even in changes of more than 10 per cent if this was shown to be necessary for the correction of a 'fundamental disequilibrium' (a necessarily vague concept).[14] On the whole area of Fund control over members' domestic policies, the final agreements also removed original provisions which allowed the Fund to require changes in policies incompatible with external equilibrium. Without these concessions, the British could never have sold the agreement to Parliament and the country, in which case the US goal of re-establishing an international monetary and trading system based upon the principle of multilateralism would have been left in shreds.

The multilateral element of the agreement was apparent in its provisions for the elimination of quotas on imports and for the convertibility of currencies on current account, though even then only after a 'transition period' after the war of uncertain length (a factor which assisted the eventual adoption of the agreement by the British Parliament).[15] There was also a clear presumption on all sides that since the rationale of a well-functioning international monetary system was to facilitate the growth and liberalisation of trade, current account restrictions ought to be discouraged, though controls on capital flows were seen as acceptable and probably necessary both to facilitate exchange rate stability and to prevent disruption of domestic monetary order.

The tendency in international relations literature to equate the 'liberalism' of Bretton Woods (and indeed the GATT) with that of the classical era of British dominance, is, as Ruggie has argued, mistaken. The Bretton Woods agreements (and even more those which followed) were the product of a necessary compromise between the principles of multilateralism and domestic interventionism.[16] What Ruggie terms 'embedded liberalism' to describe this compromise might just as well be termed 'embedded mercantilism'; in practice, primacy of place would come to be accorded to national economic sovereignty.

For the British, and especially the Labour Party, the commitment to full employment after the war and to the establishment of the welfare state was non-negotiable. This shift in domestic political forces and attitudes occurred in most major countries after the war and was reflected in a significantly greater contribution of government expenditure to GDP in the following years (see table 6.3). As a result of this development, Bretton Woods hardly constituted a clear set of 'rules' defining various adjustment responsibilities in the way that is often implied. The lack of agreement between the US and the British over the provision of liquidity and the distribution of responsibilities for adjustment between surplus and deficit states resulted in a very ambiguous compromise. All that was ruled out (and only then after the end of the transition period) was exchange restrictions on current transactions. There was also a presumption against frequent use of

Table 6.3 General government expenditures as a percentage of GDP, selected years.

Year	France	Germany	UK	US
1938	29	37	29	22[a]
1950	38	n.a.	35	22
1960	39	32	35	28
1970	39	39	42	34
1975	43	49	51	35
1980	44	49	47	35
1985	50	49	46	38

Note: [a] 1940. The figures provide only a very rough guide, due to differences in definitions and difficulties of measurement.

Source: Flora, 1983, ch. 8; Nutter, 1978, pp. 49–50; IMF, various years.

exchange rate changes for adjustment to external disequilibria,[17] but much would depend upon the extent to which in practice states would choose to exercise their right to employ that option. It is not surprising that the historian of the monetary negotiations called the agreements 'a kind of do-it-yourself kit with rather defective instructions.'[18]

Not only were adjustment responsibilities left unclear, but in one crucial area, the role of reserve currencies in the system, the silence was deafening. Financial conservatives in the US were vociferous in their criticism of the negotiations on this very point. Professor John Williams, Vice-President of the Federal Reserve Bank of New York and a leading representative of the financial establishment, argued that the US should support the restoration of a dollar-centred gold exchange standard through a stabilisation agreement between the key currencies (an extension of the model of the 1936 Tripartite Agreement between Britain, France and the US). Though there is some evidence that White and Treasury Secretary Morgenthou had sympathy with this idea, both were suspicious of what the latter had termed the 'usurious money-lenders', and also could not be seen to accept the criticism of the bankers (among others) that the provisions for the transition period contained in the Bretton Woods agreements were completely inadequate.

Keynes himself had also objected to granting a special position for any currency in the IMF articles.[19] Although it was clear to everyone that the dollar would be for a considerable time the only currency that was fully gold-convertible (at $35 per ounce), there was little discussion as to the general position of reserve currencies, what exactly 'balance

of payments equilibrium' entailed for a key currency country such as the US, and the extent to which reserve growth ought to be made up of dollars (or sterling) as well as new monetary gold. An obscure provision in the articles provided for

> the Fund by a majority of the total voting power [to] make uniform proportionate changes in the par values of the currencies of all members, provided each such change is approved by every member which has ten percent or more of the total of the quotas.[20]

This appeared to allow for a proportionate revaluation of all currencies in terms of gold (in which par-values were to be expressed), though the implications of this for the relative positions of key currencies and gold in the international monetary system were left unexplored.

The idea of Bretton Woods as a regime which, backed by American hegemony, governed international monetary relations in the postwar era also glosses over the fact that (as critics at the time charged) the agreements were completely inappropriate to the circumstances of the postwar world. Before long, the Bretton Woods framework was pushed aside to make way for new approaches. In many ways, as we shall presently see, the role of the US in the international monetary system was established *outside* the formal structure of the Bretton Woods agreements.

6.3 The aftermath of the war and the failure of Bretton Woods

By the end of the war, Britain had suffered a further dramatic weakening of its relative position. Churchill's determination to fight Nazi Germany regardless of the financial consequences had created a situation even more pressing than the aftermath of World War I. Despite Lend-Lease, Britain lost one quarter of its total national wealth in the war, had external debts in excess of £2 billion in mid-1945, and faced a massive reduction in income from shipping and foreign investments. With plans for reconstruction and recovery envisaging a high level of imports for a number of years after the war, without exports at least double the level of prewar years, it would be unable to finance the inevitable deficit with the dollar area.

This difficulty was made more acute by the fact that Britain's main trading partners in the East no longer ran a payments surplus with the dollar area (table 6.4). When the US abruptly terminated Lend-Lease in August 1945, the new Labour government had little alternative but to dispatch Keynes to Washington in September 1945 to negotiate a loan from the Americans.

Table 6.4 Size and geographical distribution of US trade balances, 1938 and 1946 ($ millions).

Region	1938	1946
Europe	+380	+1,653
Latin America	+39	+201
North America	+104	+273
Asia	−26	+218
Africa	+32	+91
Oceania	+39	−33

Source: Milward, 1977, p. 358.

The US loan to Britain of $3.75 billion, agreed in December 1945, is important for two reasons. First, the US administration saw the loan as a means of accelerating the adoption of the multilateral obligations contained in the Bretton Woods agreements. Attached to the loan were provisions for the full convertibility of current sterling-area receipts and for an end to quantitative discrimination against American goods, as well as an obligation to make sterling convertible for current transactions within one year of the effective date of agreement (July 1946). The transition period had been reduced at a stroke to eighteen months. In Britain, these conditions 'were variously seen as an encroachment on Britain's economic sovereignty, an attempt to break up the Commonwealth and Empire and a first step towards "enslaving" a socialist Britain to capitalist America.'[21] Yet the British cabinet felt that they had little choice but to accept the loan with its conditions, however reluctantly.

On the American side, the loan was sold to Congress on the grounds that Britain's key role in international trade and payments necessitated American financial assistance, though only with the conditions attached. Deteriorating relations with the Soviets eventually gave the US another reason to provide special assistance to Britain as a major ally. The loan agreement was therefore something of a concession to the key currency school's arguments for treating Britain as a special case, while at the same time an attempt to maintain the pretence that the Bretton Woods institutions were an adequate solution to Europe's postwar problems.[22]

Any such delusions were rapidly dispelled with the return to sterling convertibility on current account in July 1947. The run on the pound that ensued was so rapid that the loan threatened to be exhausted in a matter of months, with the result that Britain was forced to renounce

convertibility after only seven weeks. The attempts of the US administration to apply the Bretton Woods formula to the postwar circumstances had ended in failure, and from then on Britain would resist American and IMF pressure to accept convertibility obligations until the British government itself believed that the time was ripe to do so.[23]

Britain's difficulties were part of a larger, general problem of how the acute structural disequilibrium in international trade and payments ought to be dealt with. The need for reconstruction in many countries necessitated high levels of imports from the dollar area for the foreseeable future, with little means of financing them out of current exports. Some indication of this is given in table 6.4, comparing US bilateral trade balances with other regions in 1938 and 1946.

The United Nations Relief and Rehabilitation Administration (UNRAA), with most of its resources contributed by the US, was to deal with immediate war-relief requirements, but provided no solution to the reconstruction problem. The US government, itself concerned about the need to finance exports after the war, had placed its hopes in the International Bank for Reconstruction and Development (IBRD), set up with the IMF in 1944. However, the IBRD's resources were restricted to those that it could obtain from the international capital markets, which were inactive. As in 1919 when American official aid dried up, the world was faced at the end of the war with an imminent collapse of the postwar boom.[24]

The European crisis of 1947 remains a controversial matter. Its overt form was a 'crisis of confidence' due to widespread shortages and the breakdown of centre-left coalitions on the Continent, although the shortages were in part a product of the investment boom which had begun at the end of the war. In 1947, gross and net capital formation for all of Western Europe (outside of Germany) was higher than in 1938, itself a year of high investment due to rearmament programmes.[25] As Milward has argued, in economic terms the crisis was in the *international framework* in which the national economies were operating, above all in the prospective inability of the international monetary arrangements to finance the large US current surplus at the end of the war.

Unlike in 1920, after 1945 the transformation of the domestic political situation ruled out deflation as an option for a number of countries, especially in Britain and France. The determination of these countries to pursue a policy of rapid growth and reconstruction of their economies necessitated vital strategic imports from the US, which with the termination of UNRRA aid and other US relief aid over 1947 (and again no prospect of private investment filling the gap), could not be financed. European leaders could see the crisis looming but could think of no way out; the hope could only have been that in contrast to the post-World War I circumstances, the US would act out of its own strategic interest to produce a major new initiative.[26]

Before Secretary of State Marshall made his famous Harvard speech in June 1947, the deteriorating relationship with the Soviet Union and the perception in the State Department that Western Europe was in the midst of an economic, political and moral crisis, was bringing about an important shift in US policy. Increasingly it was felt that only a massive programme of American economic assistance to Europe could avert the disaster which threatened. The objective of Marshall Aid was an ambitious one: the path to European economic 'viability' and containment of the emerging Soviet threat would be through the economic and even political integration of Western Europe.[27] This would provide a fundamental solution to the productivity gap with the US and the supposedly related dollar shortage. It would further allow Europe to do without dollar aid by 1952 and eventually to take on the multilateral obligations of Bretton Woods. For the foreseeable future, however, the US had to accept that Bretton Woods provided no solution to the structural problems of the international economy.

It is often argued that Marshall Aid gave the American hegemon the means to exercise its economic power to achieve a new and more appropriate international monetary regime. As Keohane has written, 'the United States could use the influence provided by European reliance on its aid to take the lead in creating and maintaining a new set of post-Bretton Woods rules for the world financial system.'[28] There are two issues at stake here: first, whether Marshall Aid gave the US leverage over specific important issues in the monetary area after 1947, and second, whether the new policies and institutions that evolved constituted a new regime or set of rules as Keohane suggests.

There was not one but at least two major factions in US foreign economic policy during these years, with conflicts being regularly aired in the meetings of the National Advisory Council on International Monetary and Financial Problems (NAC). One group, comprised of the IMF, Federal Reserve Board and Treasury representatives, were against European integration to the extent that it significantly retarded the adoption of the Bretton Woods articles. The other group, led by the Marshall planners in the Economic Cooperation Administration (ECA) and State Department, believed that Bretton Woods was an ultimate goal but that European integration was a necessary first step.

Neither of these two factions fully achieved its objectives, largely because what each was proposing was something upon which most European countries were united in opposing. Countries like Britain

and France were resentful of American attempts to push them into adopting policies consistent with Bretton Woods that they saw as impossible in the circumstances. In most countries reconstruction necessitated conserving scarce dollars, which gave the US little choice but to tolerate continuing exchange controls. The 1940s and early 1950s saw an expansion of bilateral currency arrangements to a much greater extent than in the 1930s.[29] In practice, the emphasis upon investment and the step to 'viability' meant that the ECA criticised deflationary Italy and West Germany to a much greater extent than relatively inflationary France, though such criticism produced no major policy reversals.[30] If inflation *was* gradually brought under control in countries like France, there was also a clear incentive to do so from the national standpoint.

On the issue of exchange rates, it is true that the US attempted to use Marshall aid as a means of increasing surveillance over recipients' policies, arguing that any prospective changes in exchange rates ought first to be discussed with the IMF. Since this went beyond the requirement for mere notification in the IMF articles, Britain and France were strongly opposed, forcing the IMF and US Treasury to back down. The French were also criticised by the IMF for their adoption of a multiple exchange rate system, but the NAC was convinced by the ECA to drop the demand for a single French par-value on the basis that it would be politically unacceptable in France.[31]

The further deterioration of the British payments position over 1949 suggested to the NAC that what was needed for a more rapid move to economic viability and convertibility was a devaluation of sterling and other European currencies against the dollar.[32] The reluctance of the French (who had devalued the franc in January 1948) and British to contemplate devaluation when they were both concerned to resist inflationary pressures has led to the suggestion that the US 'forced' the devaluations of sterling and other countries in September 1949.[33] Cripps (Britain's Chancellor of the Exchequer), like a number of British officials, was against devaluation *alone*, because of scepticism as to whether it could improve Britain's net dollar position. The steady loss of reserves, market expectation of devaluation and mounting evidence of uncompetitive export prices in dollar markets eventually brought the British cabinet in July 1949 to vote in favour of devaluation, though Cripps was able to delay action until September 18.[34] Market forces had made the devaluations inevitable.

The move to extra-European currency convertibility and a reduction in discrimination against American goods made little practical progress in the Marshall aid years. Nor could it be argued that ECA and State Department desire for rapid European economic and political integration was a complete success. Fostering mere *cooperation* on such issues as the sterling devaluation of 1949 and within the Organisation for European Economic Cooperation (OEEC) in general had proved all but impossible.[35] Here US policy ran up against the immovable barrier of the British refusal to accept full integration into a United States of Europe, as well as the unwillingness of other major countries like France to move any faster or further along the road towards European integration than they themselves saw as possible or desirable.

In the monetary area, the ECA proposal for a European Payments Union (EPU) at the end of 1949 brought out the difficulties with the American approach. This proposal was for a new system of net multilateral settlement of balances between members of the OEEC as well as the sterling area, for the substantial elimination of quantitative restrictions on trade within the OEEC, and for an EPU Board which would facilitate the coordination of national monetary and economic policies. The ECA's objective was an ambitious one: 'a common [European] monetary system, the equivalent of a single currency', as a first step towards the eventual adoption of multilateral trade and dollar convertibility for Europe as a whole. IMF and US Treasury fears that this would represent the fusion of West European countries into a 'soft currency' sterling bloc, which would continue to discriminate against American goods, led to their insistence that the IMF administer EPU, but the Europeans refused this.[36]

The Europeans would not be pushed into monetary integration either and refused to establish a Board with powers to harmonise national financial policies. Adjustment responsibilities within EPU provided for a sliding scale of settlement in dollars and credits that aimed at putting pressure on deficit countries to adjust and surplus countries to redirect exports towards the dollar area. This enabled a compromise between the European states.[37]

Just as crucial was the end of the US policy of opposition to the sterling area. The sterling depreciation probably made some contribution to the improvement in the British payments position in 1950, but this in itself could not alleviate the difficulties posed by the sterling balances accumulated during the war. Britain was unwilling to accept anything like sterling convertibility until the US agreed to support sterling's role in EPU settlements and to ensure sterling-area insulation against conversion of sterling balances by continental countries.[38] Though EPU was a major step in the liberalisation of trade and payments within Europe and beyond, it was neither a regime imposed by a US hegemon nor a new solution to the structure of *global* payments. The Europeans were able to resist US pressure on some fundamental issues (notably integration) and established a set of institutions more appropriate to European circumstances.[39] Their ability to do so was enhanced by the development of the Cold War, which prevented the US from pushing important countries like Britain and France too far because of the potential consequences for Western security.[40]

Ironically, the American perception of continued structural economic weakness in Europe was already in the process of being outmoded over 1949, first by the large devaluations against the dollar in September, and second by the beginnings of the postwar boom in Western Germany. The exceptional growth of the German economy provided a crucial market for European exports, as well as ultimately relieving the dependence of those economies upon imports of *American* capital goods for industrial restructuring. As a result, 'several of West Germany's neighbours moved into the pattern of export-led growth which dominated the boom of the 1950s.'[41]

In contrast to Britain and the sterling area, whose external position remained more dependent upon economic developments in the American economy, the improvement of the continent's trade balance with the US meant that the boom was increasingly Euro-centric. By mid-1952, continental Western Europe was in almost exact balance on all private transactions with the US, so that the net flow of US government expenditure and aid (maintained by the military expenditures following in the wake of the Korean War) was adding to those countries' reserves, especially those of West Germany. The West German current account swung into surplus in 1951, a pattern which would lead to strains within EPU and ultimately within the international monetary system in general.

Europe's improving current account balance with the US allowed growth in European trade and output to continue largely unaffected by the American recessions of 1953–4 and 1957–8, which suggests that it is an exaggeration to hold that the boom was largely a product of growth in America.[42] The US willingness to open its markets to foreign exports, in contrast to the protectionism of the interwar period, was certainly an important factor in Europe's ability to finance imports from America (and was even more important for Japanese recovery). Official and private capital flows further improved Europe's international finances. Outside of Britain, however, the major export market for most European countries was West Germany and this country in turn sent a great majority of its exports to other European countries. Contrary to American fears, Europe had in fact made an enormous step towards 'viability' by the end of Marshall aid.

From the American point of view, the movement of its overall payments position into deficit was seen as a result of the peculiar circumstances of the time and as unlikely to persist. Though US official settlements deficits over the period 1950–7 totalled $6.2 billion, the cumulative current account surplus was $5.5 billion in spite of considerable discrimination against American goods, leaving little doubt as to the strength of the competitive position of leading US industries. The par value of the dollar in terms of gold during these years seemed unchallengeable, and the loss of $1.7 billion in gold reserves over 1950–7 was seen as a healthy redistributive movement. The rest of the deficit was largely financed through the voluntary accumulation of dollar liabilities abroad, which established the dollar as the world's major reserve currency.

World reserves grew by over $8 billion over the period, with new monetary gold and foreign exchange reserves each accounting for 46 per cent of this increase, and new reserve positions at the IMF for only 8 per cent.[43] The compound growth of total world reserves was about 2.2 per cent per annum over 1950–7, while the volume of world trade in the 1950s expanded at over 6 per cent per annum (and real output at about 4 per cent), which suggests that the growth in international liquidity was not excessive in this period. The West European countries in particular experienced high rates and stability of growth (see tables 4.2 and 4.3), facilitating adjustment to growing trade interdependence.

Though gradual *de facto* moves towards currency convertibility had been made in Europe during the 1950s, especially in those countries with strengthening payments positions, controls on current and capital transactions were the rule. London's international commodity and gold markets were reopened in the mid-1950s, but much of the trade finance business in sterling had shifted to offshore centres like Zurich. The City of London was in favour of a return to full sterling convertibility, but the British authorities were unwilling to do so as long as they feared that convertibility would only lead to massive conversions of sterling balances into dollars. This fear prompted the British to obtain the European Monetary Agreement of 1955, which established that any return to multilateral convertibility in Europe would be a collective one.[44]

By the end of 1958, the overwhelming success of economic reconstruction and the stability of the domestic social contract in Europe gave the Europeans themselves a great incentive to liberalise markets (and hence exchange controls). In the context of a major improvement in the British balance of payments and a French devaluation, the West Europeans moved collectively to adopt convertibility on current account in December 1958.[45] To the extent that the multilateral obligations of the Bretton Woods agreement became operable, they did so after the establishment of the national welfare state in Europe.

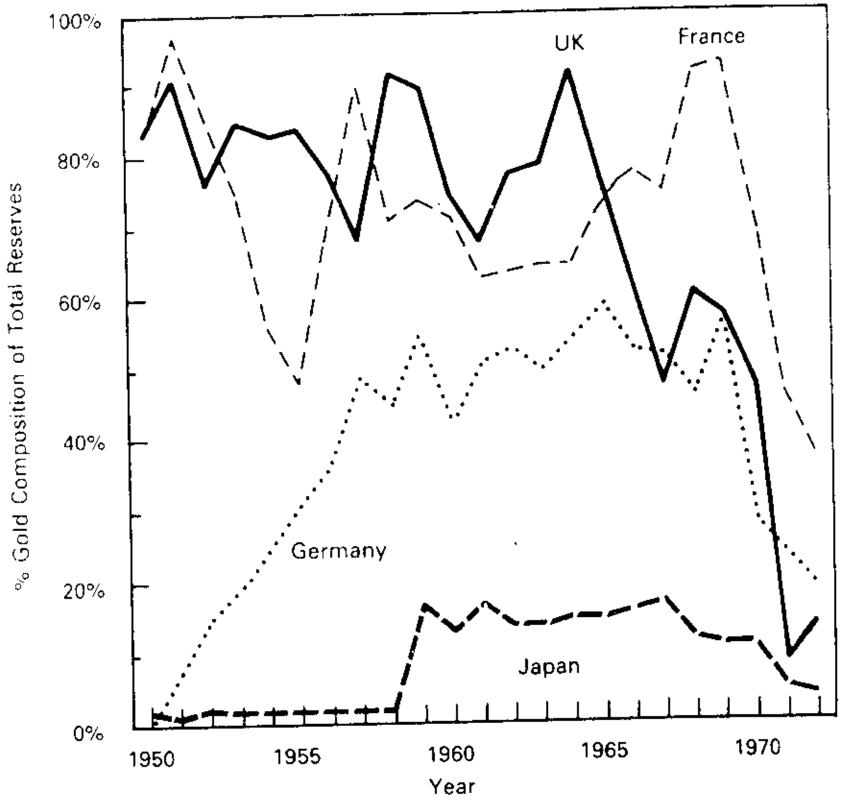
Despite this possibly unprecedented stability and growth, some strains were beginning to emerge. Of the $6.5 billion increase in monetary reserves of OEEC countries over 1950–7, the accumulation of reserves by West Germany accounted for $5 billion.[46] In addition to the role of the dollar in the international monetary system, the pre-1958 period saw the establishment of a pattern of persistent US overall deficits (but large surpluses on current account) and German current and overall surpluses. The question would soon arise as to whether these payments 'disequilibria' were unsustainable and if so, what measures of adjustment ought to be taken and by whom.

6.4 The emergence of disequilibria and the problem of adjustment

After averaging $770 million per annum over 1950–7, American official settlements deficits took a sudden turn for the worse over 1958–9, averaging $3.2 billion in these two years. The question arose as to whether this represented a temporary setback or if it heralded a fundamental worsening of the US payments position. As the US economy moved out of recession in 1959, a significant deterioration of the trade balance suggests that by the end of the 1950s the US was facing for the first time since the war serious competition in international markets for exports, especially from West German manufactures.

Imports were also beginning to make inroads into US markets in traditional areas of local producer dominance, such as automobiles.[47] From averaging $5.4 billion over 1956–7, the trade surplus fell to $3.3 billion in 1958 and $1 billion in 1959. The competitiveness of American industry seems to have improved considerably over the next few years, however, in part due to the excellent US wage and price inflation record over the late 1950s and early 1960s (wholesale prices were unchanged 1958–64) and to reduced discrimination against US exports. Average yearly trade and current account surpluses over 1960–5 were $5.3 billion and $4.5 billion respectively, at a time when the domestic economy was booming.

Another source of deterioration in the US payments position was the increased net outflow of private long-term capital from 1956. American 'multinational' companies sustained their competitive advantage by relocating production facilities abroad in these years, especially

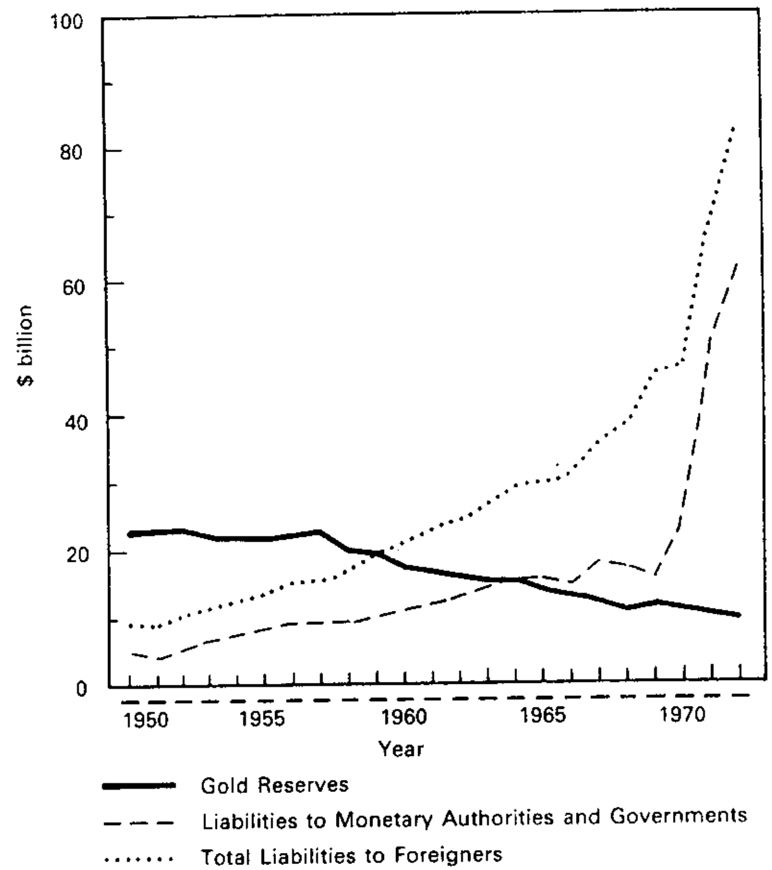


Note: Gold valued at SDR 35/ounce.
Source: IMF, *International Financial Statistics*.

Figure 6.1 Gold composition of reserves, selected countries, 1950–72.

in Europe, which was likely in the long run to erode the US trade surplus.

Perhaps most striking was the loss of US gold reserves: in 1958–9, it lost $3.4 billion in gold reserves, compared to only $1.7 billion in the previous eight years. It was not just that the US trade and overall payments position had deteriorated, but that in the late 1950s there was a shift in the reserve preference of central banks in favour of gold rather than dollars (see figures 6.1 and 6.2). Other industrialised countries had been able to accumulate monetary reserves over the 1950s because of a persistent tendency to current account surplus and net capital inflows, though there had been setbacks for France and Britain in and after the time of the Suez crisis. The US had seen the steadily strengthening reserve position of its allies as a positive sign of



Note: Gold valued at SDR 35/ounce.
Source: IMF, *International Financial Statistics*.

Figure 6.2 US gold reserves and short-term liabilities to foreigners, 1950–72.

their growing economic and political stability, though this attitude was soon to change. As the international public and private role of the dollar steadily grew over the 1950s and 1960s, the desire of the rest of the world as a whole to accumulate reserves *and to maintain their gold composition* was gradually eroding the US gold stock and ultimately the gold convertibility of the dollar at $35 per ounce. This was what Robert Triffin had recognised at the end of the 1950s and became known as the Triffin dilemma, as discussed in Chapter 3.

Though Triffin's analysis was hardly popular with the US government and monetary authorities, by 1960 there was some recognition that a problem existed when the Eisenhower administration moved to reduce the overall external deficit by measures to reduce overseas military expenditure. Publicly at least, however, the US continued to stress its determination to continue to sell gold to all those who wished to convert dollar balances at the going price.[48] To the extent that central banks tried to maintain the gold composition of reserves by obtaining gold in the *private* market, this increased pressure on the market price of gold, which underwent a flurry in October 1960 as speculative pressures drove the London gold market price as high as $40 per ounce.

The growing shortage of gold in the 1960s coincided with a major growth in dollar reserves. Over 1958–67, increases in foreign exchange reserves (almost 90 per cent of which were new dollar reserves) accounted for 72 per cent of the $17.1 billion increase in global reserves, with new gold reserves adding only 9 per cent and new IMF and BIS reserve positions 19 per cent.[49] In this same period, the cumulative US official settlements deficit was $21.6 billion, of which $10.8 billion consisted in sales of gold reserves. With Triffin having pointed out that this situation was ultimately incompatible with a fixed dollar price of gold, the monetary debate of the 1960s was centred upon how to solve the problem of the US deficit without leading to a global liquidity crisis.

The difficulty with this debate was that it was not simply a problem of liquidity, but moreover one of *adjustment*, in particular who would accept the responsibility for adjustment to this disequilibrium. In retrospect, the dispute between the Americans and their European allies in the 1960s was marked by an inability to agree on the distribution of adjustment responsibilities, due to differing diagnoses of the nature of the disequilibrium in the international monetary system. The debate was conducted in international forums such as the Bank for International Settlements, and the Economic Policy Committee and Working Party 3 of the newly formed OECD.[50] Robert Solomon, an American representative in Working Party 3 for a number of years, observed that:

> European criticisms in Working Party 3 focused on US monetary policy, which was alleged to provide excess liquidity to the American economy and to keep interest rates too low, with the result that US investors had an incentive to place funds abroad. This in turn swelled both the overall US deficit and European surpluses. American officials, in turn, argued that European countries were relying too heavily on monetary policy and not enough on fiscal policy to restrain aggregate demand . . . and repeatedly charged that Europeans tended to regard the US deficit, rather than the European surplus, as the aberration that needed correction.[51]

The Europeans argued that US dollar deficits were supply- determined and the Americans that they were demand-determined, with each side demanding that the other make the appropriate policy adjustments. In a sense, each side in the dispute was partly correct in its diagnosis of the disequilibrium. Each had focused upon two different asymmetries in the Bretton Woods system that had existed from the very beginning: the Americans upon that which favoured the running of payments surpluses and the Europeans upon that which allowed reserve currency countries to finance deficits through the issuance of short-term liabilities.

Ironically, during the war, the British had directed their efforts to removing the bias in favour of surplus countries, but American financial strength had militated against any correction of this imbalance. By the 1960s, with persistently large overall US deficits, the tables had turned, with the Americans criticising the Europeans for their seemingly insatiable desire to hold 'barren gold', their continuing restrictions on US exports, and their high interest rates.[52]

From the European perspective, an exchange rate consistent with the maintenance of a current account surplus favoured domestic exports, a high level of employment and productivity growth and reduced the adjustment costs flowing from higher levels of import-penetration. As a result, while there was a presumption on the part of most countries that resort to devaluation should be avoided (the Italian experience over 1963–4 being a good example), in the presence of persistent current account weakness they were generally willing to make large devaluations (such as Western Europe in general over 1948–9 and France in 1958). The other side of this coin was that countries with excessively strong current accounts proved very reluctant to revalue their currencies, and when they did (such as West Germany and Holland in 1960) it tended to be of small magnitude.[53]

Current surpluses also allowed the accumulation of foreign assets, foreign aid expenditure and the financing of exports without a rise in net external indebtedness. The steady accumulation of monetary reserves was an understandable objective in a growing world economy and arguably had become increasingly necessary in the 1960s, given rising trade interdependence and the growing importance of private short-term capital flows. In sum, current surpluses (or 'mercantilism') provided an important cushion for the national welfare state in an increasingly interdependent world economy.

For the Europeans, the problem was the asymmetry which allowed reserve currency countries, above all the US, to finance excessive deficits by flooding the world with dollars. The political attention given to the large US capital outflows in the 1960s revolved in part around the idea that the privilege conferred on the US by the key currency status of the dollar allowed it to exchange paper dollar assets for control over European resources. The French in particular, not altogether unreasonably, held that the periodic conversion of dollar reserves into gold at the US Treasury was the main means of placing an external constraint upon American policy. Any solution to the international payments disequilibrium should therefore come from the US, though whether tighter US monetary policy was in European interests is debatable. Certainly, the Europeans (let alone America's other trading partners) did not want to see a devaluation of the dollar relative to other currencies. Large US current account surpluses over 1960–7 (averaging $4 billion per annum) suggest that the dollar was not overvalued during these years; without large net outflows of long-term capital these current surpluses with the rest of the world would not have been sustainable. Most people recognised that any dollar devaluation *vis-à-vis* other currencies would probably be met with retaliatory devaluations.

Even if the US had been successful in reducing its outflow of long-term capital and official foreign expenditure, foreign governments would have been forced into adopting restrictive measures to deal with a dollar shortage. In the Kennedy and Johnson eras, various measures to reduce the long-term capital outflow (the Interest Equalisation Tax, voluntary and finally mandatory capital export restrictions) were attempted, along with other measures to reduce the costs of official foreign expenditure (such as the various 'offset agreements' with West Germany). The failure of these programmes significantly to reduce the deficit was in part due to the private and official demand for dollars as the major source of international liquidity, as well as domestic US financial regulations and the unwillingness of the US to place punitive restrictions upon corporate foreign investment or US banks' Euromarket activities.[54] More generally, the overall US deficit was consistent with the global role adopted by America after 1945. As David Calleo has written:

> In reality . . . the United States had no real intention of giving up its foreign 'burdens', including the tribulations of monetary hegemony. Overseas troops and investments were expressions of American ambition and power as well as idealism. The United States was not running deficits to provide liquidity to others, but as a by-product of pursuing its domestic and foreign ambitions.[55]

There was also a broad European desire for continued American engagement in Western Europe's affairs, which made Europe's position in the international monetary debates somewhat tenuous. The debate on international monetary reform was caught in an impasse, with neither side willing to accept responsibility for adjustment to the

payments disequilibrium or to alter the basis of the postwar political–military structure. To many, this seemed to be the result of 'the redistribution of economic power between the reconstructed economies of Europe and Japan on the one hand, and of the United States on the other . . . [preventing] the advanced countries from meeting the crisis in a coordinated fashion.'[56] In order to decide whether the crisis was due to a relative decline of American power, we need to consider the various proposals for the reform of the system.

6.5 Solutions to the systemic disequilibrium?

The main solutions urged upon the governments at the time by academics and officials were perhaps four: an increase in the gold price, a move to greater exchange rate flexibility or even floating exchange rates, a full dollar standard and centralised liquidity creation through an enhanced IMF.

Gold and reserve currency country adjustment

Until around 1967, the health of the US current account suggests that the disequilibrium which had arisen in the gold exchange standard was due to the shortage of gold rather than an overvaluation of the dollar in terms of other currencies. This suggested to some a need for an increase in the price of gold in terms of all currencies, so as to revalue US gold stocks and increase the flow of new monetary gold into the system.[57]

Opposition to this proposal was very strong. Triffin called it a 'false solution', while the official US attitude from the time of the gold market flurry in 1960 was that the $35 per ounce price of gold was the 'pillar of the postwar system'.[58] American policy, from the organisation of the Gold Pool in 1961 aimed at stabilising the market price of gold to the Two Tier Arrangement of 1968 which abandoned the long attempt to prevent the private market price of gold from rising above the official price, was set firmly against any change in the official dollar price of gold. As a result, over the 1960s the gold convertibility of the dollar was placed in increasing doubt and the international monetary system evolved from a gold exchange standard towards a dollar standard.

An initial argument made against the gold price proposal was that it would not be distributionally neutral. The main beneficiaries of such a rise, it was held, would be the gold market speculators and the world's major gold producing nations, the Soviet Union and South