

**LEADING ARCHITECTS OF THE INTERNATIONAL  
FINANCIAL ORDER: FROM BRETTON WOODS TO THE 1970s**

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## **CHAPTER ONE**

### **ESSENTIAL ELEMENTS OF A DOCTRINAL APPROACH**

#### INTRODUCTION

From the mid-twentieth century the clash of ideas on the organisation of the international financial system became more amplified than at any time in history. Controversies in international finance seems to reach a crescendo when evoked by war, impending or actual depressions and financial crises. Only then is the viability of existing international financial relationships called vigorously in to question. The range and diversity of proposals on international financial reform offered by economists from about the mid-twentieth century was unprecedented.

The merits of particular forms of international financial arrangements have been debated on and off for centuries. Events such as the 1930's economic depression and economic reconstruction following the Second World War placed international financial reform squarely in front of politicians and policymakers concerned to enhance or retard, as the subject demanded, international economic interactions such as freer trade and cross-border investment. More recently these issues have re-surfaced under the guise of 'international economic integration' or 'globalisation'.

International economic events and associated monetary upheavals in the twentieth century have been accorded much analysis in some outstanding economic histories (e.g. Solomon 1977, 1999).<sup>1</sup> The genesis of international financial arrangements in the second half of the twentieth century in both their economic and political dimensions has also been given considerable research attention. For instance, retrospectives on the performance of the 1944 Bretton Woods Agreement and the international financial system established thereafter, are widely available (Scammel 1975, Tew 1988, Bordo and Eichengreen 1993). Two magisterial studies covering

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<sup>1</sup> Nurkse (1944) represents the best example of a thorough study of a history of the international financial system in the interwar years. Nurkse brought to the fore benefits of studying international financial "experience" as opposed to idealistic plans for reforming international financial arrangements. He damned the latter with faint praise, noting that they "may have certain attractions in theory" (p. 20). For a modern counterpart of Nurkse with the necessary changes for late twentieth century experience see Obstfeld (1995).

events and policies from 1944 to the 1970s deserve special mention. First, there is J.K. Horsefield's (1969) three volume study of the International Monetary Fund (IMF) which concentrated on the institutional evolution of that organisation in the context of an international financial system governed by rules established at Bretton Woods. Secondly, there is Harold James's International Monetary Cooperation since Bretton Woods (1996) which highlights actual experience in financial arrangements between countries, ongoing amendments to the Bretton Woods system and the effects of events and institutional changes on the evolution of international finance up to the 1970s.

Notwithstanding the important contribution made by these studies, along with the vast array of monographs, journal articles and conference compendia which have improved understanding of international monetary events and reforms in practice, a crucial dimension of the subject remains blurred. No searching study has been conducted on the development of international financial ideas and doctrines since the Second World War.<sup>2</sup> Doubtless the neglect of doctrinal research may be ascribed to a decline in the popularity of intellectual history in the discipline of economics since the 1940s.<sup>3</sup>

This book will examine competing economic doctrines embodied in plans, blueprints and proposals offered by prominent economists for international financial reform following the Bretton Woods Agreement in 1944 and concluding at the point where Bretton Woods arrangements were dissolved in the 1970s. The substantive ideational content of the Bretton Woods Agreement which established codes of conduct for participants in the international financial system, has been widely discussed. Doctrinal studies on the 1940s concentrate almost exclusively on the Keynes and White plans which formed the initial basis for negotiation over the final Bretton Woods structure (Gardner 1969; Mikesell 1994; Eichengreen 1994). Key proposals and ideas contributed by luminaries in the economics profession in the 1944 – 1974 period have been neglected; many of these vigorously opposed the Bretton Woods arrangements. It will be the purpose of this book to make these ideas accessible, give

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<sup>2</sup> In a parallel field Irwin (1996) contributed a widely applauded doctrinal study of international trade doctrine. For partial, rare exceptions in international finance see Begg and Wyplosz (1993) and Guitián (1993).

<sup>3</sup> For a stinging rebuke of economists and a compelling case for rehabilitating the history of economic ideas in the education of economists see Blaug (2001).

the reader an appreciation of their richness, subtlety and intellectual strength. The latter turns pre-eminently on the internal logical basis of each set of ideas and the originality or innovativeness of the principles, concepts and analytical frameworks made available by the authors concerned. To the extent that originality and innovativeness also related to specific policy implications for governments and international financial organisations charged with managing the international financial system, the empirical relevance and practicability of the ideas will also provoke discussion and comment in the following chapters. Intellectual rigour will constitute only one element in the exposition of each doctrine; consideration of feasibility, taking account of political constraints, will also have a place. In short, the propagation of a particular set of ideas cannot be fully understood without appreciating their practical, policy implications.

This book will describe how and why different ideas on international finance were formulated, who formulated them, and why certain doctrines enjoyed more commanding positions in the debate amongst economists and policymakers at particular times; why other ideas fell from favour, appeared too idealistic, obscure, too radical, or were regarded as infeasible or at worst downright cranky and idiosyncratic. This book's preoccupation with ideas will remedy the fore-mentioned imbalance in the literature produced by economists and economic historians; it will treat ideas first and foremost as abstract considerations relating to issues in international finance without direct reference to events and immediate policy pressures. In this I shall be following the recommendations of some of the most celebrated thinkers in twentieth century economics. John Maynard Keynes announced in his General Theory of Employment, Interest and Money (1936) that there were two principal reasons for reflecting on economic ideas in their own right: first, because "the ideas of economists....are more powerful than is commonly understood" and secondly because "the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas" (p. 383). And I also follow Friedrich Hayek who wrote in Monetary Nationalism and International Stability (1937) that one is justified in confining attention at least provisionally to "theoretical problems" in the monetary field because "in the long run human affairs are guided by intellectual forces. It is this belief which .....gives abstract considerations of this sort their importance, however slight may be their bearing on what is practicable in the immediate future" (p.94). In

his monumental History of Economic Analysis (1954) Joseph Schumpeter also endorses the study of economic ideas in the purest sense. What all this means for the evolution of ideas on international financial problems is that the origin, motivation, scope and content of economic ideas should be understood first. In reflecting on the Bretton Woods international financial arrangements so widely accepted in principle in 1960s, Herbert Grubel (1963:11) recognised that

the dreams and impractical plans of one generation are often the political and economic dogma of the next. The present international monetary system is itself the outcome of plans developed by men who analyzed what was wrong with the system of the 1930's. Resistance to change now makes us the slaves of ideas worked out twenty years ago.

#### ON THE INTELLECTUAL ARCHITECTURE OF THE INTERNATIONAL FINANCIAL ORDER

The quest for national and international economic stability from the 1940s to the 1970s prompted many economists to act as 'architects' of international financial reform. Various blueprints, nostrums and pragmatic schemes for reconstructing or renovating the 'system' have recently been likened to architectural projects (Bank for International Settlements 1998; Eichengreen 1999). Like architects economists have drawn up plans - some with a clear conception of an extant structure in mind, others with a stated desire to modify key pillars of a current structure. Still other economists have designed structures beginning with a clean slate of possibilities, without appreciating the need to account for the merits of an existing structure, and with scant respect for immediate practical contingencies or national political imperatives.

Certainly material presented in the following chapters may usefully be considered as sets of intellectual constructs or designs with contrasting features, advantages and disadvantages. As purely intellectual creations they may be propounded and subsequently studied and appraised for their relative aesthetic appeal, just as the art of designing physical structures may be undertaken for aesthetic reasons rather than for immediate functional purposes. However, architecture as a discipline is also pursued with a view to confronting special environmental conditions. Likewise, the

architecture appropriate for particular, observable international financial conditions may need to have more than purely aesthetic appeal. Therefore, many of the ideas examined below will make references to functions as well as logical form, that is, to existing circumstances which make the design relevant and more appealing as a resolution to a problem with an existing structure.

Important clarifications must be made at the outset concerning the notions of "doctrine", "system" and "order" used in following chapters. Intellectual constructs proposing to change or re-make international financial arrangements resemble what Schumpeter (1954:38) called "political economy". These involve articulation of a doctrine: a "comprehensive set of economic policies" advocated by their authors "on the strength of certain unifying (normative) principles". Now the doctrine may comprise ideas on the essential structure of an international financial "order" and the financial "system", to use Robert Mundell's (1972:92) terminology. An order "represents the framework and setting" in which international financial arrangements – the financial system – operates. Many of the Schumpeterian doctrines on international political economy surveyed in this book are concerned not with the system, that is, the modus operandi of the international financial order. Instead, they consider the "framework of laws, conventions, regulations and mores that establish the setting of the system and the understanding of the environment by the participants in it. A monetary order is to a monetary system somewhat like a constitution is to a political or electoral system" (Mundell 1972:92).<sup>4</sup>

When passing from the formulations of the architects about the international financial order and their advocacy of policies to be adopted within that order, the precision of economic analysis must usually be abandoned. For policy discussion invariably deals with a world resonant with imperfections and approximations.<sup>5</sup> At any one time, any real international financial system is a hybrid form of the architects' ideal construct; it

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<sup>4</sup> By contrast Solomon (1977:5) conflates "system" and "order" in his definition of the international monetary system. "We may", he writes, "define the international monetary system as the set of arrangements, rules, practices and institutions under which payments are made and received for transactions carried across national boundaries".

<sup>5</sup> Scammell (1975:17) therefore considers the notion of an international monetary order unhelpful since it "implies a mechanism of interrelated parts functioning for some clearly defined end, according to known laws. It implies knowledge, certainty and predictability". To be sure, the ideal order will never be found in reality, though the general constructs of the architects will identify functions, arrangements and practices common to many factual states of affairs.

possesses attributes of the ideal financial order in varying degrees. In other words the architects produce stylized "schemes of interpretation" (Machlup: 1978:251) explaining many features of a real, evolving financial system, though ideal-typical examples of their construction can never be observed in reality. The architects of international finance write down thought experiments or generalised abstractions and much of the discussion that follows in subsequent chapters will consider these abstractions. As abstractions they constitute variegated types of economic theory constructed with reference to the broad contours of an existing economic epoch. General rules of each international order so constructed may be fully outlined by each architect and interpreted with detailed provisions and contingencies relevant to contemporary circumstances or an imagined future set of circumstances. Often reference to concrete circumstances overshadows reference to general abstract principles governing an international financial order, so much so that the architect will appear to offer an eclectic plan or proposal for financial reform.

Overall, the aim of the following chapters is to compare ideas on financial orders and associated systems. The orders constitute formal "rules of the games" (McKinnon 1996:24) guiding each nation's participation and operation in an observable, historically specific international financial system. In the discussion that follows use of the term system will apply to the day-to-day "mechanisms governing the interaction between trading nations, and in particular the money and credit instruments of national communities in foreign exchange, capital, and commodity markets" (Mundell: 1972).

## CHOICE OF LEADING ARCHITECTS

In explaining the essence of each doctrine on international finance this book will use the following questions for guidance:

1. What are the expected objectives and requirements of a genuinely international financial order and its associated systems?

2. What key aspects of the existing system were targeted for reform (e.g. exchange rate regime; capital account liberalisation, role of international financial institutions and so forth)?
3. In the immediate period after the Bretton Woods Agreement, did economists' interpretations of interwar experience influence their proposals and how did their expectations of the post-war world influence their ideas?
4. How well, if at all, did the economists' doctrines identify defects in the existing Bretton Woods financial order that would lead to serious problems later and how might their proposals have avoided these problems?
5. In different doctrinal traditions on international financial reform, what were the normative bases of reform proposals?

Not all doctrines expounded in the 1944-74 period will be considered in the light of the foregoing questions. The choice of doctrine and 'leading' architect(s) of that doctrine rests on several considerations. First, the doctrine must be significantly differentiated from others where differentiation implies either major framework changes incommensurable with another architectural form or major changes in the existing system which were controversial and extensively debated at the time. Secondly, the leading architect or group of architects must be associated with a tradition or school of economic thought and policy which has long-standing in the discipline of economics and may have received a distinctive title (e.g. Austrian, Chicagoan, Keynesian). Thirdly, the doctrine must have had a dominant intellectual influence in the sense that it has been widely recognised and cited by contemporaries and subsequent commentators. Fourthly, the cosmopolitan nature of international political economy demands that the coverage of 'leading' doctrines must go beyond Anglo-American economic thought in the period under review; thinkers of continental European origin (and perhaps resident in Europe) will be chosen where appropriate.

This book will present a procession of leading ideas – an historical array of doctrines – mostly in chronological order and classified where possible by school of thought on the subject. As for possible omissions from the 'leading architect' category, it should

be realised that major contributors to the pure economics of international money may not have reflected extensively on order or system reform issues. In that case they will not be given special attention here. Account must be taken of M. June Flanders' International Monetary Economics 1870 – 1960 (1989) which treats pure economic analysis and does not study the relationship between relevant ideas and policy questions connected to the international monetary order or system. Thus James Meade, a key contributor to the economics of the balance of payments in the 1950s and 1960s, figures in Flanders' work as an economist who made notable analytical advances, but that does not in itself qualify him for 'leading architect' status.<sup>6</sup> By contrast Roy Harrod's contributions, while not given much space by Flanders, will be given careful treatment here because he wrote extensively on system reform and international financial policy.

Crucial to the doctrinal orientation adopted here is the need to preserve ideas about international financial orders and systems that appeared irrelevant or infeasible at the time they were articulated. Mundell's valuable distinction between financial orders and systems permits consideration of alternative orders even if they were constructed to house a hypothetical international financial system. The story will begin with the Bretton Woods international order already in place. The plans of J.M. Keynes and H.D. White – leading architects of Bretton Woods – will not be considered in detail. Instead the fundamental ideational features of Bretton Woods will be outlined in the next chapter. The Bretton Woods outline will function as a benchmark for subsequent architectural projects beginning with two Harvard University based contributions: Alvin Hansen's American Keynesian reinterpretation of Bretton Woods and John H Williams's "key currency" approach which proposes an alternative financial order to that constructed at Bretton Woods. Frank Graham at Princeton offered a wholesale rejection of Bretton Woods and his broad commodity reserve currency proposal later drew support in Europe from Nicholas Kaldor and Jan Tinbergen. The plans and arguments of Robert Triffin produced at Yale University in the 1950s and 1960s also deserve a full chapter treatment. Triffin salvaged what he thought were the best elements of the Bretton Woods order and reworked some of its central principles.

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<sup>6</sup> The same comment applies to pioneering work at the IMF on balance of payments difficulties and adjustment problems in the 1950s and 1960s by Jacques Polak, Sidney Alexander and J. Marcus Fleming. On these achievements see Endres and Fleming (2003).

Well-known economists at the University of Chicago – notably Milton Friedman and Harry Johnson – railed against the Bretton Woods order for over two decades; their Chicagoan alternative is discussed in Chapter Seven. Perhaps a more radical approach than that of the Chicagoans was taken by the Austrians – Hayek, Mises and Rothbard – together with some French, German and Swiss-based economists. The Austrians favoured resuscitation of the automatic gold standard and their views are explained in Chapter Eight. Chapter Nine considers more eclectic positions formed around what was to become known as the "Bellagio Group" of thinkers on international financial reform (named after four conferences on the subject held in Bellagio, Italy). The group was led by Fritz Machlup and it formed a consensus around some central elements of the Bretton Woods financial system as then observed. In addition Roy Harrod in Cambridge U.K. offered a distinctive British Keynesian perspective laced with some interesting eclectic elements. The last leading architect and more recently a Nobel Laureate in economics, Robert Mundell, made a critique of Bretton Woods and offered an alternative proposal on regional monetary unions; his views will be studied in Chapter Ten.

Chapter organisation will conform broadly to the following pattern: (i) introducing the leading architect or group of architects; (ii) explaining their interpretation of the evolution of the Bretton Woods financial system up to the point in time when they made their key contributions; (iii) analysing the principles forming the basis of their alternative doctrine; (iv) outlining institutional arrangements constituting the proposed system; (v) stating their views on alternative proposals and plans (if any); (vi) assessing the normative basis of their proposal (vii) appraising its feasibility and (viii) setting out assignment rules or guidelines for the main instruments of economic policy in the context of the proposed international financial architecture.

## ECONOMIC IDEAS AND INTERNATIONAL FINANCIAL POLICY: NORMATIVE ISSUES

Referring again to Schumpeter's conception of political economy, the intended approach to international political economy in this book openly accepts normative elements. Various architects of international finance were active advocates of an order and associated system; they often made specific policy recommendations.

Furthermore their plans and proposals exhibit some common features: they embody alternative visions of the nature, scope and consequences of intercountry monetary interactions and interdependencies; they favour a specific set of rules or loose guidelines for the international financial order; take different positions on the necessity for joint responses to perceived negative spillover effects arising from international financial interactions and consider different roles (if any) for international financial institutions in this connection.

All intellectual constructs in international political economy are inherently prescriptive; they proceed, sometimes implicitly, to state how policymakers ought to behave given deeply held presuppositions about the nature and consequences of international financial interdependencies. Generally, such presuppositions may embrace the entire spectrum of relations among national governments designed to react to cross-border financial spillovers. As a result, for instance, some ideas discussed below envisage limited scope for monetary policy coordination between nations.<sup>7</sup> Other doctrines are far more sanguine about strong forms of policy coordination compatible with an overarching financial order, while still others propose much weaker policy cooperation thereby preserving a greater degree of domestic policy autonomy.<sup>8</sup>

The main task in this book is not to study the impact of key economic and financial events on ideas. Nor is the task to assess the way in which events and policies have been influenced in practice by certain ideas or changes in economic knowledge. The deficiencies of the Bretton Woods financial order were gradually revealed by events and failed policies associated with the rules and guidelines applying to that order. Flaws in Bretton Woods were often perceived by economists' doctrines independently of events and usually before the full implications of that order had been revealed in practice. The policy implications of leading doctrines will carefully be appraised in the first place as part of the contemporary intellectual scene. The coherence and

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<sup>7</sup> By "coordination" I mean the management and occasionally significant modification of national policies in recognition of economic interdependencies among nations. See Frenkel, Goldstein and Masson (1996).

<sup>8</sup> Bryant (1995:13-14) offers a useful taxonomy which describes a range of economic interactions among nations along a continuum from mutual recognition, to weak cooperation and to strong coordination in the context of an international financial order embodying shared principles, rules and codes of conduct.

theoretical robustness of a doctrine may be considered against the backgrounds of critiques made of it at the time and later. Here analytical validity is a prime consideration. However, separating analytical issues in international political economy from those which might be resolved by observation and formal empirical investigation is not straightforward. While during the period under review economists placed great faith in the methods of positive economic science especially empirical falsifiability, events, data and institutions could not easily be marshalled in a widely agreeable manner conclusively to test a particular doctrine. The problem was exacerbated by the fact that disagreements among economists over the organisation of the international financial system were sometimes due to semantics such that different meanings were attached to different terms commonly used in international finance.<sup>9</sup> As well, the future-oriented character of international financial reform proposals prevented real experimentation taking place to test crucial propositions. When particular experiments were undertaken for example in the design and scripting of the roles of the World Bank and IMF in the Bretton Woods financial order, controversy continued unabated on whether or not these roles were successful. While many questions about the impact of international financial interactions and about the effectiveness of certain policies have been tentatively answered by positive economic analysis and empirical work, key normative issues remain unresolved. All that matters for the purposes of this book is that different value judgements need to be exposed because they are responsible for divergent policy recommendations.

The propagation of a doctrine in international finance cannot be understood without appreciating the policy implications arising from it. For it is undoubtedly these matters which provoke controversy among economists and policymakers. The normative issues including political and ideological factors are inextricable aspects of each doctrine – they take for granted how the international financial order should work, or what aspect of the order or system should be modified. Some political scientists have attributed a pivotal role to ‘embedded liberal’ ideas in the construction of the global financial order from the mid 1940s (Ruggie 1983; Helleiner 2001). Another has interpreted the evolution of the Bretton Woods system as the playing-out of certain power relations manifested in financial imperialism. (Cohen 1970). It

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<sup>9</sup> Fritz Machlup (1963) attempted to reduce the confusion among economists about key financial terms, with some success.

therefore behoves any serious doctrinal study in economics to elucidate normative elements contained in each doctrine. Economic arguments developed by each leading architect discussed in the following chapters are often concerned to facilitate a more efficient allocation of the world's resources; some are also concerned to generate greater equity in the sense of allowing opportunities for less developed nations to participate more freely in any proposed financial order, trade openly with more developed industrialised nations and raise their economic growth rates. Additionally, some proposals wish to promote a specific type of 'fairness' in the distribution of burdens when economic adjustments to balance of international payments difficulties are required. Finally, a widely held presumption embodied in doctrines surveyed below is that each doctrine on financial arrangements is intended to be consistent with a companion, parallel position on international trade, trade policy and associated institutional arrangements.<sup>10</sup>

#### MAIN PURPOSES OF A DOCTRINAL PERSPECTIVE

On December 18, 1963 a conference organised by Fritz Machlup and Burton Malkiel was held in Princeton to discuss "International Monetary Arrangements". Thirty two selected economists with expertise in the field were invited. The invitation to the economists read:

The purpose of this conference is.....to find out whether we can identify the differences in factual and normative assumptions that can explain the differences in prescription for solving the problems of the international monetary system. Presumably we all use logic. Hence, if we arrive at different recommendations, we must differ in the assumption of fact or in the hierarchy of values. To identify and formulate these assumptions would.....be a major step toward a better understanding of the conflict of ideas (Machlup and Malkiel 1964:7)

This passage expresses in capsule summary the purpose of this book at least in terms of executing doctrinal study. There is one difference: expositions, commentaries and assessments in this book have benefited from events, ideas and controversies since the 1960s. Doctrinal study enables us to understand the strengths and weaknesses of

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<sup>10</sup> Companion trade doctrines will not feature in this book. Readers will find Irwin (1996:180-206) useful in this connection.

present international financial arrangements and provides insight into the wide range of alternatives available to policymakers.

Reviewing the development of doctrines on international finance can render a sense of proportion to current debate on the subject. Revisiting past contributions also serves to demonstrate the influence of fads in economic writing and indicates what might have been fashionable in the generally accepted mainstream of economics on the subject from time-to-time (Bronfenbrenner 1966). For modern practitioners there may also arise an unpleasant realisation from contemplating doctrinal studies: the progress of research in the field of international financial reform and international policy coordination does not appear to exhibit a linear movement away from darkness (past error) toward light (present truth). While many questions about specific arrangements in the international financial system and their effectiveness have been satisfactorily answered since the 1940s, still others – especially important normative issues – have not by their very nature been settled once-and-for-all, though they have been, and still can be, openly debated. This doctrinal study will present many normative questions on international finance which still pose challenges to the present generation of economists and policymakers.

Doctrinal discussion of sets of ideas on the international financial architecture can illuminate some fundamental, enduring and quite modern principles commonly used in the field (e.g. scheme feasibility, credibility, rule-commitment and enforceability).<sup>11</sup> There is no suggestion, however, that the following study will resolve long-running disputes over normative issues, many of which are still alive today. Doctrinal discussion cannot decide for the reader which approach or architectural scheme is correct for a particular period or is supremely compelling in current circumstances. An array of schemes will be presented for readers to judge. In this I follow Scumpeter (1954:40) once again in likening these scheme to a form of political economy in which, for example:

There would be no sense in speaking of a superiority of Charlemagne's ideas on economic policy as revealed by his legislative and administrative

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<sup>11</sup> On these principles as employed in late twentieth century research on international financial reform, see Frankel and Goldstein (1996).

actions over the economic ideas of, say, King Hammurabi; or of the general principles of policy revealed by the proclamations of the Stuart kings over those of Charlemagne; or of the declarations of policy that sometimes preface acts of Congress over those Stuart proclamations. We may of course sympathize with some of the interests favoured in any of those cases rather than with the interests favored in others, and in this sense array such documents also in a scale of preference. But a place of any body of economic thought in any such array would differ according to the judge's value judgments, and for the rest we shall be left with our emotional or aesthetic preference for the various schemata of life that find expression in those documents. We should be very much in the same position if we were asked whether Gauguin or Titian was the greater painter...And the same thing applies of course to all systems of political economy.

Retrospectives only permit reasoned reflection on views articulated in a particular time and context. They explain, for instance, why contemporaries viewed a doctrine either as having maverick qualities that made it anathema to supporters of a received doctrine on the international financial order, or as possessing qualities that rendered it amenable to modifying the current international financial arrangements.

The following doctrinal study will identify schemes that have a modern flavour – doctrines that have perennial character and appeal. Ideas from the leading architects of international finance laid-out below may be conferred the title of 'fertile' constructs in international political economy, though only in historical perspective. Their ideas were already in the air when more persuasive proponents of arrangements such as flexible exchange rates, monetary unions, and free world capital markets came on the scene in the late twentieth century. As one modern commentator in the history of economic thought has argued, the practices of past generations of economists still shape our current thinking whether we are aware of it or not (Blaug 1996:7). This comment is especially relevant in the debate among economists on international financial reform. Doctrinal research therefore has a modest function. It can identify key features of older ideas that have not become obsolete. Given our conception of

the ebb and flow of architectural forms in international finance, it would have been extraordinarily short-sighted to place these ideas on the scrap-heap.

While modern terminologies and expressions on the issues might differ, doctrinal disputes in the 1944-1974 period were then, as now, concerned with fundamental questions: (i) does the configuration of the international financial order matter? (ii) does that configuration expose participating nations to so-called violent fluctuations in international financial markets which reduces long run growth prospects at the national level? To use modern idioms, these fluctuations mostly caused by an international financial architecture (promoted in the doctrines of one or more leading architects) could weaken the case for enhancing global economic integration predominantly based on market forces; they could threaten the otherwise laudable cases for freer world trade, the transnational integration of supply chains in product and services markets and freer world capital markets. That is why many (but not all) the architectural schemes constructed by economists whose work is surveyed in the following chapters seem so preoccupied with the questions of international financial order and stability.

Each chapter below relies on primary sources to provide direct access to the content and style of reasoning in the work of selected, leading architects. Informed readers working outside the formal discipline of economic should remember that each architect's first points of reference were the intricacies of the existing international financial system and the proposals and plans of other 'experts'. As one leading architect ruefully affirmed:

These.....are formidably technical topics. To deal with them in simple, commonsense terms, would inevitably classify the author as a crackpot whose views deserve no more than a raising of eyebrows and a shrugging of shoulders on the part of serious-minded people. I felt compelled, therefore, to meet the experts .....on their arguments, and to anticipate their objections. This makes unnecessarily forbidding reading for the layman. (Triffin 1960:vii).

Nonetheless, an attempt will be made below to make the material accessible to a wide audience extending beyond the narrow confines of specialist economists and those interested in international finance. The latter now seem disproportionately concentrated on topics in the positive economics of international money; accordingly they are obsessed with measurement and empirical issues.<sup>12</sup> Readers with interests in international finance, political science, international organisations and international relations should keep the following point in mind throughout: in all instances where a leading architectural scheme is expounded below, the international financial order was perceived by the architect(s) as an instrument for facilitating the transfer of goods, services, labour and capital among nations. And it has been almost axiomatic in economics since Adam Smith that such transfers are generally wealth-creating. This is essentially why the leading architects identified in each chapter tools strong interest in designing and constructing the instrument.

Lastly, to anticipate one of my conclusions, the appearance of an international financial order and the associated system at the time of writing (in early 2003) will disabuse economists of a belief in their supreme architectonic power. Economists have often taken the view that the international financial system must be designed and managed in some determinate way and that they have the analytical tools to do the job. In fact, economist's ideas may not clinch an argument or act as a perfect predictor of observed outcomes in international finance; those outcomes evolve organically as the undersigned results of events, politicians' policy choices and the decisions of a multitude of market participants. None of these factors must necessarily conform to the dictates issuing from the minds of economists. Furthermore, like most economic policy analysis the architecture of international finance appreciated as doctrine is an art more than a science like engineering. As with architectural work per se, work on the international financial architecture incorporates a style (or genre) only later clearly visible to historians.

I turn in the following chapter to examining a founding attempt to engineer the international financial order. The Bretton Woods Conference held in New Hampshire, July 1944, created a governing blue print for international finance. Not

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<sup>12</sup> A quick perusal of the most popular journal in the field, the Journal of International Money and Finance published by Butterworths will confirm this impression.

without good cause, the blueprint has been described as "one of the great social inventions of the twentieth century" (Gordon 1971:vii) and as "a notable landmark in human affairs" (Harrod 1972:5).

## CHAPTER TWO

### THE BRETTON WOODS FINANCIAL ORDER – A DISTINCTIVE ECONOMIC DOCTRINE

#### SOME INTELLECTUAL BACKGROUND

When Ragnar Nurkse's study for the League of Nation's entitled "International Currency Experience" (1944) was distributed to delegates at the United Nations Monetary and Financial Conference at Bretton Woods (hereafter: BW) in July 1944, his conclusions would have been scarcely surprising and indeed widely accepted. As the last major economic research contribution of the League, Nurkse's study contained all the fundamental seeds of the BW Agreement. The interwar years from 1919 illustrated how, without a sound legal and institutional framework for the international financial order in which all major industrialised nations sought to cooperate, the result would be generalised economic disorder. Financial disorder brought deleterious economic, social and political consequences. Commentators have since discussed these consequences at length: trade wars, severe economic depression, rampant economic nationalism, competitive currency devaluations and even, to stretch the point, military conflict. Nurkse's major conclusions should briefly be outlined here for they give open entry to the factors uppermost in the thinking of economists at BW.<sup>13</sup>

#### Exchange Rates

In the first place, the twenty years between the wars had furnished much evidence against freely flexible exchange rates between currencies that is, flexibility in the price of a nation's money expressed in terms of others. On Nurkse's reading of the evidence flexible rates had overwhelming disadvantages: (i) because trade in goods and services is hampered by the uncertainty engendered by fluctuating rates while hedging facilities merely add to the costs of trading currencies over time; (ii) movements in exchange rates much larger than justified by changes in relationships

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<sup>13</sup> The following account of the principal conclusions in Nurkse (1944) draws heavily on his final chapter (pp. 210-32). For a modern assessment of Nurkse's contribution to international monetary economics and policy, see Endres and Fleming (2002:167-96).

among nations' internal price and cost levels result in disruptive shifts of resources in and out of industries producing exports and (iii) exchange rate movements in a particular direction promote anticipation of movements further in that direction, leading to speculative capital transfers between currencies, aggravating and in some cases thwarting orderly adjustment of a nation's balance of payments (if the current account on the balance of payments is in deficit or surplus).<sup>14</sup> In short, the world needed "stable exchanges" since these have "proved essential not only for international economic intercourse but for domestic stability as well" (Nurkse 1944:211). Exchange rate stability is a matter of degree; certainly Nurkse rules out "absolute rigidity" in the face of major, long term structural changes in economic conditions when rates may need to change. Ensuring exchange rate stability is considered a prerequisite for the stabilisation and management of domestic economies.

### Foreign Reserves

Secondly, according to Nurkse, the functions, form and distribution of international financial reserves need clearly to be understood by all nations participating in an international monetary order sanctioning fixed exchange rates. Presuming stable, relatively fixed exchange rates – meaning that residents of a country may convert their domestic money into foreign money at a fixed rate – international, foreign money essentially becomes an extension of domestic money.<sup>15</sup> Thus gaps in a nation's international payments due for instance to a deficit in receipts over payments for trade in goods and services, must somehow be settled. A nation's cash reserves of foreign currencies (held at the central bank and/or at commercial banks) would be used to settle a deficit. Alternatively a surplus would increase these reserves. In any event, institutional arrangements of this sort permit convertibility of one nation's currency into another; they are essential when residents of different nations make payments to each other yet hold a high proportion of their money in the form of domestic currency.

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<sup>14</sup> Later in the twentieth century in the context of more developed, sophisticated foreign currency markets, economists are still observing warily how "some participants in the exchange market rely on a 'follow-the-leader' approach; changes in the exchange rate thus reflect a bandwagon effect. Hence there may be 'speculative bubbles' in the exchange rate" (Aliber 1987:212).

<sup>15</sup> Without entering the technicalities, a singular nominal exchange rate is the nominal price of two national monies; this rate (or price) ought perfectly to parallel, over a long period of time, the real purchasing power over goods and services of those moneys in each of the national economies (i.e. the nominal and real exchange rate should coincide over the long run).

In brief, the functions of a nation's foreign reserves is to facilitate convertibility in a fixed exchange rate environment. Discrepancies between foreign receipts and payments may arise due to normal trading activities and will usually be larger when affected by non-synchronised cyclical movements in economic activity among nations, crop failures, long running labour disputes, natural disasters and so forth. Thus a store of international monies will soften the domestic impact of such shocks. These monies may take the form of foreign currencies supplemented by foreign borrowing facilities, trade credits and gold holdings. Instead of acting as a purveyor of changing economic conditions from abroad, increasingly during the interwar period international reserves came to act as a buffer stock absorbing international economic shocks. The new-found macroeconomic policy aim later in the 1930s turned on "a growing desire for economic stability; there was a growing realisation of the need to maintain national income and outlay so as to secure an adequate level of employment" (Nurkse 1944:213). As part of this trend, the policy practice of "sterilizing" the effects of foreign reserve movements on the domestic credit base was widely observed.<sup>16</sup> This practice – offsetting or stabilising for instance, adverse movements of foreign export demand on domestic output and employment – implied greater tolerance for social and political reasons of government management through a central banking authority of the external accounts. As for the broad economic rationale underlying this move, Keynes's General Theory of Employment Interest and Money (1936) had already provided the locus classicus but resort to this practice was widespread before 1936.

In the post-1944 international financial order, Nurkse recommended that liquid reserves be established and constituted by foreign currencies and gold, with the mix of currencies being determined by the diverse trade patterns of individual nation states. Crucially, reserves should be used as a buffer only for "temporary discrepancies" between international payments and receipts. It was believed that signals transmitted by long run market forces (produced by taste changes, technological and productivity

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<sup>16</sup> Nurkse p. 213, 215. Formally, in a fixed exchange rate environment, sterilisation amounted to using monetary authorities such as a domestic central bank; authorities would intervene by purchasing or selling "foreign-currency bonds that are matched by equivalent sales or purchases of domestic currency bonds, leaving the monetary base unchanged" (Obstfeld 1995:176). That is, a change in the Central bank's net foreign currency reserves is offset by a corresponding change in its net domestic assets so that monetary liabilities (the monetary base) remains unchanged.

advances) could be garbled especially in the short term and no damage could therefore be done by intervening during that period. (1944:214).

The emerging buffer function of international reserves in the 1930s implied an inverse relationship between a country's national income and its international liquidity (as measured by the reserve position). Previously, "legal stipulation requiring country's to hold a certain minimum 'cover' of gold or foreign exchange reserves against their notes in circulation or the notes and sight deposits combined". Increasingly, this stipulation lost its prestige and acceptability (p. 215). As for the distribution of foreign exchange reserves among countries Nurkse concluded that the interwar period exhibited a chronic maldistribution caused by unequal wealth distribution, economic devastation from wars or natural catastrophes, speculative capital movements and possibly inadequate reserves relative to trade-financing requirements. In either of these events, without an adequate buffer against balance of payments shocks, countries were forced to use trade restrictions, myopic beggar-thy-neighbour currency devaluations to maintain export competitiveness, or allow foreign exchange fluctuations fully to impact on the domestic economy (pp. 217-20). It is suggested that resolving reserve maldistribution problems may be found in: (i) better managing international capital movements, especially "disequilibrating" speculative capital flows; (ii) officially subordinating the gold stock and changes in it, to the growth of money income, which entails legally augmenting the supply of gold by revaluing gold in terms of its exchange rate with national currencies; and (iii) securing international agreements that somehow engineered acceptability of a wider range of foreign currencies perceived as genuine international finance held in central bank reserves.

### Capital Movements

The third lesson from interwar currency experience drawn from Nurkse's study is that exchange rate stability required government intervention to impose controls on capital movements ("exchange control"). Controls were particularly necessary when capital movements disrupted balance of payments adjustment (away from either a deficit or surplus on current account toward balance). Here the "mass psychology" connected with "hot money" and "flight capital" required rational management (pp. 220-221). And such management must be symmetrical. In fact, countries accruing large, persistent surpluses on their balance of payments current account "may constitute the real source of trouble"; they may be "the centre" of an international financial

disturbance (p. 223). By contrast, it was commonly assumed that only small, open economies suffering deficits must manage capital flows more carefully. In the surplus nations' case, their currencies would be rendered "scarce" (p. 224) by insufficient domestic demand for foreign imports or inadequate foreign lending. An "international stabilisation fund" or "exchange union" ought then be established to receive short-term loans from the surplus countries which would then be recycled by international agreement to deficit countries.

The Nurksian penchant for exchange controls is set against a clear warning: "exchange control is plainly a harmful and obnoxious means" of dealing with chronic or persistently recurring deficits (or surpluses) on the current account of the balance of payments. In the deficit case for example, exchange controls could be used to protect a national currency which was seriously overvalued. To block capital movements which have responded to a persistent deficit is tantamount to destroying the price signals so essential to efficient allocation of the world's resources.

Nurkse's League of Nations Doctrine in 1944: The core proposals from economic work completed at the League of Nations in 1944 may be stated as follows: the international monetary problem was one of determining a configuration of currency relations compatible with the requirement of domestic economic stability understood in loose Keynesian terms as sustaining a high level of output and employment. Concerted international action was required to resolve the problem. The first task was to secure a set of workable currency exchange ratios ("parities") at least for the major industrialised nations. Given gold's role as an important token in international reserve holdings, gold should continue to have an official place in the international financial system. Furthermore, international cooperation was required to mitigate the effects of erratic, "abnormal transfers" of private capital across national borders and accordingly defend established exchange rate parities. Additional cooperation was needed between large industrialised nations to effect some degree of monetary and fiscal policy coordination so as to combat "violent fluctuations" in their incomes. As a consequence, small export dependent open economies would find secure markets for their products (p. 230).

Certainly, it is acknowledged by the League of Nations economist that the nineteenth century gold standard did not emerge from a formal international agreement or constitution. However, merely to wait for spontaneous adoption of a new international financial order could invite a post-war economic depression.<sup>17</sup> It was inconceivable in 1944 that governments would stand by idly given the consensus building around Keynes's General Theory (1936). On Nurkse's recommendation only two aspects of the gold standard pre-1914 and the occasionally operative gold-exchange standard in the interwar period should be retained. First, international prosperity will be furthered by a fixed exchange rate system. Second, no post-war system should deny contemporary conventions in international finance. Therefore gold had an undeniable role though it should emphatically not act as a limit on the production of money in any domestic monetary system, or as a brake on the expansion of international trade by restricting international liquidity.

#### BRETTON WOODS: FIRST PRINCIPLES

The Bretton Woods (BW) International Monetary Agreement in 1945 has been discussed, dissected and analysed by countless historians, economic historians and economists.<sup>18</sup> This chapter does not intend to offer thorough retrospective accounts of the origins of the BW Agreement, of its workings in practice or of its actual performance and effectiveness. I wish to outline the Agreement as a distinctive doctrine, that is, as a unified Schumpeterian political economy bound by normative principles. It is vital to view the Agreement creating what was later dubbed the BW "international monetary order" (Mckinnon 1996:41-3) as a blueprint – a set of constitutional rules and guidelines for the world economy. It must not be seen as a precise guide to the actual conduct of participating nations within that order over the period from its promulgation in 1945 to its widely acknowledged demise in the early 1970s. By comparison, the actual operation of the nineteenth century gold standard corresponded very imperfectly with the rules which academic economists formulated as a model or representation of that international financial order. As Bordo (1993:36) maintains for the BW order – its "architects never spelled out exactly how the system

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<sup>17</sup> There was a consensus among economists in 1944, especially on the eastern side of the Atlantic and in Australia that "a serious depression" was likely when the war ended (Cooper 1993:105).

<sup>18</sup> Some of the best commentaries are Gardner (1969), Horsefield (1969), De Grauwe (1989), Bordo and Eichengreen (1993) and James (1996). Kahn (1976) has shed light on its historical origins.

was supposed to work". Indeed, the workings of the BW principles established in the 1944 Articles of Agreement were somewhat flexible and open-ended; they were interpreted over time in a manner not obviously consistent with the intentions of the architects.<sup>19</sup> All this would not have surprised major contemporary observers including George Halm (1944:174) who reported that the BW Agreement "will be flexible enough to fit the post-war world, whatever its success.....in a world wide scheme of economic stabilization". Be this as it may, clear guidelines were set, forming a framework within which an international financial system could be constructed, much like architects could set out the main pillars of a construction which detailed characteristics of a building that might eventually evolve.

The formal BW Agreement follows all the elements of Nurkse's study of International Currency Experience. The Agreement dealt with exchange rate stabilisation, foreign reserve creation and distribution, foreign reserves conceived as a 'buffer', exchange controls, scarce currency problems and the creation of international institutions aimed at policy cooperation and coordination. Furthermore, BW promoted a rule amounting to a full-blown case against readily flexible (and floating) exchange rates; it granted governments discretion to manage (rather than passively to accept) immediate impacts of price and income changes brought about by temporary international trade and payments disturbances. The policy background was one in which a broad consensus had already formed around the desirability of governments managing and fine-tuning national aggregate expenditure (consumption, investment and government outlays) to maintain high levels of domestic employment. Lastly the BW Agreement indirectly acted as a facilitator of multilateral trade even though trade policy issues were not debated at the conference. BW set in train international financial arrangements which would contribute to exchange rate stabilisation and multilateral currency convertibility, both of which potentially enhanced trade in goods and services. Protectionist, restrictive trade policy practices no longer needed to be the first resort in responding to international payments imbalances.

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<sup>19</sup> After 1945, as Harold James (1996:30 and chapters 3, 4) argues, BW was "a very different sort of system to that which did in fact emerge.....For a long time it might well have appeared that Bretton Woods was more of an unrealized idea". And Michael Bordo (1993:73) similarly finds that by "1968, the international monetary system had evolved very far indeed from the model of the architects of the Articles of Agreement".

Specific principles relating to financial questions are reconstructed and paraphrased below, in keeping with the original BW Articles of Agreement. The core principles are outlined without labouring the minutiae. Important in effecting the reconstruction is recognition that capturing what was intended by the BW architects is not a straightforward matter. Many previous interpretations have been made using hindsight and have been coloured by events and developments in economic terminology and understanding since 1944. Therefore I shall make the following reconstruction using original documents and as much contemporary interpretative literature as possible.<sup>20</sup> My objective is to express the core ideas around which an architectural consensus was formed at BW.

1. International Monetary Fund (IMF)

Create a permanent, impartial international financial institution – an International Monetary Fund to:

- (a) promote financial cooperation and function as a centre for consultation and collaboration on financial problems;
- (b) facilitate expansion and growth of international trade, thereby supporting the policy priority of maintaining high income and employment;
- (c) assist in establishing exchange rate stability, orderly exchange rate adjustment and avoidance of competitive currency devaluations;
- (d) assist in establishing multilateral payments in respect of transactions on the current accounts of member nations' balance of payments;
- (e) eliminate foreign exchange convertibility restrictions which hamper multilateral trade;

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<sup>20</sup> This reconstruction is assisted by original documents contained in Horsefield (1969) as well as the United States Department of State "Proceedings and Documents of the United Nations Monetary and Financial Conference" (1948). Secondary contemporary readings of the BW Agreement were also helpful: Crowther (1948:325-35); Goldenweiser and Bourneuf (1944); Haberler (1944); Halm (1944, 1945); Harris (1944); Lachmann (1944); Lutz (1943); and Mikesell (1947, 1951).

- (f) monitor (and generally tolerate) restrictions on capital transactions;
- (g) provide confidence to member nations by giving access to the IMF's resources to assist in correcting balance of payments imbalances;
- (h) provide guidelines to correct maladjustments in members' balance of payments without resorting to measures ultimately destructive of output and employment and
- (i) shorten the duration and lessen the extent of imbalances in international payments among member nations.

## 2. The IMF's Resources

Structure. Member countries subscribe to the IMF in gold and national currencies. Each member is assigned a quota, the gold component of the subscription being a minimum of 25% of quota or 10% of its net official gold reserves and US\$, whichever is the smaller. IMF holdings provide a reserve on which members may draw to meet foreign payments obligations during periods of deficit imbalances on the current account of the balance of payments. This facility is linked to the BW intention to reduce exchange restrictions and exchange discrimination on current account transactions (for trade in goods and services), and promote currency convertibility.<sup>21</sup>

Financial Assistance. The IMF does not lend its resources. A member remits to the IMF an amount of its own currency equivalent (at an agreed par value) to the amount of foreign currency it wishes to purchase for current account transactions. In due course the member must repurchase its own currency from the IMF within three to five years. Repurchase may take the form of a payment in gold or US dollars or a convertible currency acceptable to the IMF. Certain charges are levied in proportion to the amounts transacted and the duration of the arrangement. In total, no member country can purchase foreign currencies

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<sup>21</sup> Convertibility meant the ability for individuals (and governments) to complete current account transactions – paying for receiving amounts for trade in goods and services and also for foreign investments (and receipts or spending by governments from (or in) foreign jurisdictions). The ability to effect such transactions must not be subject to exchange controls otherwise convertibility is compromised.

with its own in an amount which would leave the IMF holding its currency to the extent of more than 200% of its quota.

Technical Assistance. Officials are employed by the IMF and are despatched to member countries deemed needy of economic and financial advice. Often the officials will be involved in advising on and monitoring, IMF programmes designed to assist balance of payments adjustment.

### 3. Exchange Rate Rule

Each member must maintain an agreed par value for its currency. Gold convertibility (into one or other currency) is mandatory. Thus gold or a currency tied to gold is to be used as a common denominator setting initial par values.<sup>22</sup> IMF consultation is required for any change in excess of 10% from the initial parity.

All currencies are to be treated equally or symmetrically insofar as no special reserve currencies are sanctioned, though liquid reserves were needed to defend the fixed exchange rates (par values). Each country is therefore obliged to intervene in foreign exchange markets and buy (sell foreign reserves) their own currency when it is in excess supply and sell (buy foreign reserves) when it is in excess demand. Daily exchange transactions on the market must be conducted at rates not varying by more than 1% from the par value. Clearly reserve assets, possibly IMF resources, are needed for intervention purposes.

In circumstances of long term “fundamental disequilibrium” in the current account of the balance of payments, the IMF offers extensive consultation and may permit a proposed exchange rate change to assist in payments adjustment. Objections by the IMF to the national social and political policies of member

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<sup>22</sup> As it happened, from 1945 (and certainly the process was completed by 1950), the United States was the only country with a direct gold peg, valued at US\$35 per ounce. The United States held about 70% of the gold possessed by world monetary authorities at this time (De Grauwe 1989:15). McKinnon (1996:44-49) later dubbed the actual system with formed around the BW order "the fixed-rate dollar standard" because other currencies were fixed against the US\$ which was in turn pegged to gold at a fixed rate. The US\$ was not mentioned in the Articles of the Agreement even though it became a key currency.

countries proposing an exchange rate change is forbidden. In the case of a fundamental "scarcity" (as officially declared by the IMF) of a country's currency due to persistent surpluses on current account, other members may be permitted to impose restrictions against transactions with that country, thereby implying some degree of trade policy discrimination against the "scarce currency" country.<sup>23</sup>

#### 4. Reserves and Their Use

Countries should restrict deficits to that which can be financed by official reserves and IMF drawing rights. Reserves are to be used as a buffer, allowing time for a nation to adjust to a short term external payments imbalance. IMF drawing rights for additional reserves allow, under specified constraints, access to a pool of currencies. Provision is made for four yearly reviews of the size of a member's drawing facility so that it may be adjusted to reflect inflation and the growth of international trade in goods and services.

#### 5. Exchange Controls

Use capital controls to counter currency speculation which might otherwise force inadvertent parity changes. The IMF is empowered to determine whether specific transactions in foreign exchange markets are capital or current account transactions. Current transactions, that is those needed to finance trade in goods and services, should generally be free from controls.

#### 6. International Investment

Create a coordinating institution concerned with long run economic reconstruction and economic development projects. The International Bank for Reconstruction and Development (IBRD) is to be established for these purposes.<sup>24</sup> Its main function is to act as a financial intermediary, a conduit for

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<sup>23</sup> See Bernstein (1945) for a careful dissection of the BW Articles Agreement on the scarce currency question.

<sup>24</sup> The IBRD subsequently became part of the World Bank group. See Krueger (1998).

world capital intended for long term investment projects (not short term balance of payments financing). The IBRD is to have two major powers: (i) to borrow from private capital markets, then lend on commercial or near-commercial terms to worthy projects and (ii) to guarantee loans made directly by private creditors.

## COMMENTARY

While an elaborate code of conduct for international financial cooperation was drawn-up in the original BW Agreement, the degree of ambiguity and openness in many of its founding principles provide considerable room for contention and reinterpretation. No matter how much detail is provided in each "Article" (or clause) of the Agreement, observers could not only quibble over fine technical points; major principles as outlined above were open to a wide range of interpretations. Through all the noise of interpretation, however, and there was much of that in the debates that followed the Agreement, the signal - viewed here as the style of policy analysis and core substantive content of the BW doctrine - is abundantly clear.

The contrast between patent disorder in international financial affairs in the interwar period and the BW Agreement could not be sharper. BW satisfied the Nurksian, League of Nations' plea for cooperation around key principles: exchange rate stability, orderly exchange rate adjustment when required by long term current account conditions; international liquidity (or reserve) arrangements with a buffer role; encouraging free multilateral currency convertibility and payments practices; retention of gold as a stabilising anchor; use of exchange controls to support a fixed exchange rate rule, and the inviolability of national macroeconomic policy which could still, in principle, employ a variety of economic and social policies as befitted national circumstances. Overlaying the whole Agreement was an abiding consensus formed around a policy goal structure which gave full employment top priority – a goal that must be engineered by government management in the international sphere. Full employment was not regarded as something achievable automatically by relying exclusively on the long run outcome of the free play of markets in the international

financial arena.<sup>25</sup> The ultimate point of BW was to design a system of international payments central to which were intergovernmental cooperation and government intervention in international finance. The BW order was intended to allow any system which evolved within its bounds to encourage trade expansion as opposed to supporting bilateral trade, rampant protectionism and pernicious, competitive currency devaluations (De Vries 1969:19-21).

As is well known – and this occurs with most policy packages and agreements - the BW Agreement was the outcome of compromise between mostly British and United States officials whose separate plans (the Keynes and White Plans respectively) were submitted for conferees' deliberation (Kahn 1976; Eichengreen 1989). The Agreement envisaged that all the principles established in the separate parts (or "Articles") would be mutually reinforcing. Superficially understood, the Agreement appears to satisfy this requirement. For instance, the principles which established the IMF as recounted earlier in this chapter were stated at a very high level of generality. These almost appeared as leitmotifs, or at worst slogans around which member countries could rally. The principles were also a counsel of perfection.

On the exchange rate principle it was thought that the BW rule would not suffer either the rigidities of the fixed rate system under a gold standard or the wild fluctuations believed to characterise a flexible rate system. Moreover, the use of capital controls to stem the tide of speculative capital flows would engender greater stability in exchange rates. And after all it was stability that mattered most, for stability in BW reasoning promotes trade. But in which direction should stability be reached when a change is called for? The meaning of 'fundamental disequilibrium' allowing a major exchange rate change appeared prima facie to apply to all countries whether experiencing persistent deficits or surpluses on current account. However, this expectation is not made explicit in the Agreement. Bemused by fine distinctions made in the scarce currency clauses of the Agreement, contemporary observers immediately suspected that the BW architects "lay practically the whole burden of correcting any disequilibrium on those countries which find themselves on the deficit

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<sup>25</sup> What is one to make, therefore, of the following contemporary remark? "The concept of international equilibrium as the product of freely competitive forces operating in world markets for commodities and services is basic to the policies and operations of the Monetary Fund as it was conceived by its authors". (Mikesell 1947:501, emphasis added).

side of the disequilibrium" (Crowther 1948:334). Which country or countries should in fact adjust? Surplus or creditor countries are arguably in a state of disequilibrium along with deficit countries. Did the architects intend that the burdens of adjustment in the move toward 'stability' involve "joint responsibility" as a commentator later suggested? (Scammell 1995:116). Contemporaries were more sceptical: "Unfortunately the Agreement is entirely vague concerning the policies of the creditor countries which would help restore equilibrium" (Halm 1944:172). On this matter Halm proceeds to fill lacunae remaining in the Agreement. Both creditor (surplus) or debtor (deficit) countries in a state of long run 'fundamental disequilibrium' ought to have been given clear policy direction. In the creditor case, policy should support expansion of foreign investment; rising domestic credit; increases in money wages; tariff reductions which boost imports and currency appreciation. As for the latter, in the view of Halm and other prominent contemporary observers, "appreciation can scarcely be read into the plan. Yet it may be pointed out that the case for appreciation of a scarce currency is, theoretically, just as strong as the case for depreciation of a deficit currency" (p. 174). Finally, on the exchange rate adjustment rule, there was confusion over the precise operational meaning of a 'fundamental disequilibrium'. The term was not formally defined. How would such a state be identified in practice? The concept was meant to be taken seriously; its architects seemed to presume that the state would easily be recognised by policymakers (assisted by IMF officials) when it was confronted.<sup>26</sup>

On the reserves question, liquidity used to finance world trade would not be increased by the Agreement. Currencies and gold would only be recycled through the IMF in a manner that would make them readily available. As formally constituted, the IMF had no power to create money, produce a new unit of account, or loan its resources. Members must buy foreign currencies required under strict conditions and only when there were relatively small, short term payments disturbances on current account transactions. An alternative doctrinal position on all this would have followed Keynes (1943a:27) who had wished for an IMF with credit-creating power:

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<sup>26</sup> Gottfried Haberler (1944) complained, quite correctly from an academic point of view, that the term 'fundamental disequilibrium' was opaque and ambiguous. Perhaps so, but the BW Agreement was not designed for purists.

Just as the development of national banking systems served to offset a deflationary pressure which would have prevented otherwise the development of modern industry, so by extending the same principle into the international field we may hope to offset the contractionist pressure which might otherwise overwhelm in social disorder and disappointment the good hopes of our modern world. The substitution of a credit mechanism in place of hoarding would have repeated in the international field the same miracle, already performed in the domestic field, of turning a stone into bread.

The undeniable persuasive power of Keynes's rhetoric while appealing to many audiences did not carry conviction with officials in the United States who feared the potential inflationary impact of the credit creation mechanism advocated by Keynes. Keynes's expansionist doctrine, increasingly popular among many prominent economists at the time, did not hold sway in 1944, thereby implying, rightly in my view, that the BW Agreement was not as Keynesian as it might have been.

On exchange controls Keynes (1943a:31) railed against capital flight undertaken for political reasons or to evade taxation. In addition, capital moving into a country not employed for long term investment purposes was deemed suspect; it should permanently be regulated. Central control of capital flows must in Keynes's view be an abiding feature of the post war international financial system (Crotty 1983:623). Similarly, Nurkse (1944:103) questioned short term capital movements which sought "safety rather than employment" and he condemned the use of capital for currency speculation because it caused balance of payments disturbances rather just acting as an aggravating factor threatening exchange rate stability.<sup>27</sup> The BW Articles of Agreement on capital controls were not so strident in criticising short term capital flows and speculative capital. Article IV, Section 3 calmly provides that "members may exercise such controls as are necessary to regulate international capital movements". No prior approval from the IMF is required. As Margaret De Vries (1969:224), an official historian of the IMF revealed:

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<sup>27</sup> Nurkse distinguished in principle between equilibrating and disequilibrating capital movements; he provides examples of the meaning of 'hot' money (disequilibrating movements) and its treatment by policymakers during the interwar period (1944:16:72 note 1, and 102).

As the Fund's.....Articles were drafted against the background of the disturbing capital movements that had taken place during the 1930s, there was an understandable desire to prevent movements of 'hot' money and to minimize the risk that inadequate foreign exchange reserves could be depleted by more or less panic – inspired capital transfers.

That the BW capital controls were driven by a particular reading of the international financial upheavals in the 1930s is one thing; clear guidance proffered to BW-member countries in respect of capital movements is not forthcoming. The BW principle on capital controls fails to distinguish between 'hot', presumably speculative capital, and other types of capital beneficial to trade and economic development. While the guidelines on controls is rather hazy, a clear normative position emerged. Foreign capital which is not directly allocated to new fixed investments of an income-generating type or with potential income generating power should be studiously monitored, regulated and prohibited. The entry of such capital into the domestic economy was based on allegedly 'irrational', panic-driven motives, speculative motives and on illegal tax evasion, all of which had no place in the BW financial order.

The BW architects offered a heavy-handed approach to world capital supplies. That approach was matched by an extraordinary (by late twentieth century standards) breadth and depth of governmental controls on domestic financial markets during post war years. For example interest rate ceilings as well as government restrictions and directions on bank lending, were the rule rather than the exception in most western industrialised economies. The regulation of domestic and international capital supplies went hand-in-hand with the popularity of national economic planning: economic development paths need to be mapped out by governments with a view to maximising output and maintaining high levels of employment. Finally on the exchange controls question, free international capital flows could not be openly endorsed by BW architects given their commitment to the principle of non-interference in domestic policy. The corollary of this principle of autonomy is that foreign capital movements must obviously be restricted since they may easily disrupt

domestic capital markets which invariably lacked depth and sophistication in the 1940s.

The most unclear aspects of the BW Agreement relate to the policies which might be adopted, consistently with its exchange rate rule, to create and maintain full employment and high output at the national level. There is no denying that the Agreement was founded on pursuing high growth and full employment using the international economy as a springboard. The creation and maintenance of free, multilateral international payments and freer trade goes with the BW Principles. However, can the pursuit of domestic full employment be reconciled so easily with these objectives? For example, could countries live without exchange controls on current transactions (upon which they had heavily relied during wartime), assuming that they could be distinguished from disturbing, speculative capital transactions? What was the desired mix of domestic monetary and fiscal policies consistent with the BW obligations? Granted, increased trade protectionism and competitive currency devaluations are ruled out. Domestic monetary policy may have to be calibrated in a manner which supports the fixed exchange rate; if monetary policy is too expansionist it could create pressure on international reserves which would rapidly diminish. The conduct of monetary policy is not spelt out in the BW Agreement. Yet monetary policy required careful design given the spirit of times in favour of active, discretionary monetary actions with a bias toward expansion and in particular toward accommodating fiscal policy. The matter becomes more complex once it is acknowledged that satisfying BW principles depends crucially on adopting consistent domestic policies. Just as the BW international financial order takes on the appearance of a system (in practice) of managed flexibility (with a set of loose rules and guidelines), domestic macroeconomic policy would need to have the same general orientation.

Protecting member nations' policy autonomy is an outstanding feature of the BW Agreement. The idea is given clear expression though it resembles window dressing. For while the domestic monetary and fiscal policy mix is not normally subject to the jurisdiction of the IMF, exchange rate stability and the state of a nation's foreign reserves are governed by the BW Agreement. Since the latter are not independent of the choice and operation of domestic macroeconomic policies, it may be inferred that

the BW international financial order merely tolerates different styles or shades of government macroeconomic stabilisation policy which, driven by contemporary political necessity and dominant economic doctrine, would be charged with achieving and maintaining high levels of employment come-what-may. The BW principles were idealisations. It cannot be claimed that the BW architects uncritically generalised from the principles to actual policy practice in diverse contexts. The potential conflict between the principle of non interference in domestic policies and the exchange rate stability requirement was surely understood though the tradeoffs were not made clear probably because member country circumstances were quite different.<sup>28</sup>

Undoubtedly, the BW principles were a compromise. As impatient commentators ever since have complained, the balance of payments adjustment process consistent with these principles is left up in the air. Presumably domestic macroeconomic policy action is required as soon as reserve losses (for example) are indicated and initial IMF drawing facilities are utilised. Precisely what policy action? The BW Agreement offers no direct advice. In the long run the whole burden of adjustment must fall on the exchange rate if no other policies are enacted (Scammell 1975:110). Consider the following scenario: a balance of payments current account deficit, indicative of a 'fundamental disequilibrium' should lead to an exchange rate devaluation. Domestic financial conditions would at that point be in a parlous, crisis state, yet only then would the IMF agree to currency devaluation and only then would market forces lead to adjustment of domestic expenditure, costs, wages and possibly government outlays. And, only at that point would the costs of domestic policy objectives foregone by not adjusting macroeconomic policies earlier, be realised. The BW Agreement takes for granted that member nations would make necessary monetary and fiscal policy changes (to switch and/or reduce domestic expenditure in the appropriate direction) in the short term when initially using their IMF drawing facilities. Needless to say, there are no enforcement measures in the Agreement guaranteeing that policymakers will act appropriately.

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<sup>28</sup> C.f. Halm (1944:174) in whose view the architects "who drafted the Agreement know that they cannot hope to integrate policies of the members to the degree required for perfect exchange stability".

Underlying the non-interference principle is a belief in policymakers' power actively to use monetary and fiscal policy depending on domestic political constraints and a presumption that such policies can have a potent impact on output and employment in the short term. Reading between the lines of the Agreement, when entering international obligations under BW it is asserted that the self interests of national political decision makers, under pressure to maximise public popularity in short electoral cycles, will be overcome by a cooperative spirit of responsibility in international finance. Perhaps this position is justified on the strength of a fundamental causal relation in BW doctrine: exchange rate stabilisation precedes and is at least a first step toward domestic economic stabilisation rather than the other way around.<sup>29</sup> Therefore the domestic macropolicy mix is a secondary consideration. According to Paul De Grauwe (1987:922), the whole cooperative intent of BW was inspired by the very same idea. Further raking over the historical record of interwar international financial experience or further learned empirical work would not have moved BW architects on the direction of this causal relation. High in their collective memories was the searing experience of exchange rate volatility in the interwar years. It is therefore little wonder that scant attention was paid at the BW Conference to what BW architects considered as second order issues. Reconciling BW international financial principles and guidelines with the design and operation of disciplined national monetary and fiscal policies would follow naturally on the achievement of exchange rate stability.

#### POLICY ASSIGNMENT GUIDELINES AT BW: A RECONSTRUCTION

In obtaining membership to the BW international financial order and complying with the Articles of Agreement, members needed to submit to the admittedly broad, implicit policy guidelines embodied in the system. The international BW rules were straightforward enough since they are outlined (if rather loosely) in respect of exchange rate management, membership subscriptions, drawing rights and scarce currency arrangements. Other matters in the Agreement (such as exchange controls)

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<sup>29</sup> As already discussed, this belief was also forged on the minds of League of Nations' economists, represented by Nurkse (1944). Barry Eichengreen (1996:52) demonstrated that Nurkse's critics (and by extension BW critics) "contended that policy instability was a given and exchange rate instability its consequence. In their view the exchange rate responded to policy whereas Nurkse saw causality running also in the other direction".

amounted to guidelines rather than formal rules. The principle of non interference or domestic policy autonomy seems vacuous because it is inextricably linked to the exchange rate commitment, specifically the BW fixed rate (but adjustable in the long run under special conditions).

Whither a completely autonomous monetary policy in all this? If a country adopted a very expansionary monetary policy thereby producing more national money to the point where its international acceptability (against gold or the US\$) declined, a foreign reserve drain and eventual exchange rate crisis would supervene. The BW international rules and guidelines do not prevent inconsistent policies developing at the national level - policies that could impact negatively on an originally stable exchange rate. IMF consultation and advice or even cajoling did not carry strong, credible enforcement. The spectre of national insolvency in an economic crisis might be the only effective antidote for domestic macroeconomic policy indiscipline.

It is too simplistic to propose that the BW architects blithely accepted the achievement of exchange rate stability as a guarantor of policy discipline at the national level. Equally, it is inconceivable that the architects would not have had clearly in mind a linking of their international rules and guidelines to specific types of national policy actions implementable when divergences appeared in a country's international accounts. Two types of divergency are possible: firstly in the temporary, short term situation and secondly at the point where a 'fundamental disequilibrium' is experienced. In the first case a country with a deficit and exercising IMF drawing rights would responsibly implement macroeconomic stabilisation policies designed to minimise the risk of exhausting IMF entitlements. In practice it is known in retrospect that certain types of policies using specific monetary policy instruments were favoured by the IMF in the period up to the 1970s (Spitzer 1969). Actual practice notwithstanding, the original BW architecture did not formally recommend rules for the operation of national monetary and fiscal rules for the operation of national monetary and fiscal policies in the face of balance of payments disturbances. Certainly, as Eichengreen (1994: 50-51) has emphasised in respect of monetary policy, the BW Agreement excluded "robust monetary rules".

I am led therefore to reconstruct what BW architects must have thought about the assignment of a range of economic policy instruments to the policy objectives in hand.<sup>30</sup> The question of "assignment" concerns the procedures that should be followed to relate available policy instruments to economic and social objectives (Williamson and Miller 1987:13). The first objective was usually considered to be high employment, then high output growth, balance of international payments, price stability, and a reasonable income distribution. Strictly speaking BW architects dealt with the international payments objective, though because the objectives often conflict, attempts to achieve the international (external balance) objective would inevitably impact on the others.

In correcting balance of payments disturbances in the short term the exchange rate instrument could not be used; par values can only be adjusted when long run disequilibrium emerged. This is why reserve positions were developed both domestically and at the IMF to avoid the need for continuous balance of international receipts and payments. And the implicit rule for reserves is that employing them in exchange market interventions must not be allowed to impact on the domestic monetary base; monetary policy must therefore be conducted actively to sterilise the use of foreign reserves.<sup>31</sup> The domestic money stock must decline to restrict the demand for foreign currencies all the more so when excess demand is persistent. The sale of foreign currency by a central banking authority in this situation comes in return for local currency which is automatically removed from circulation. An obvious danger is that governments might not permit this automatic rule to apply immediately – they may alter monetary and fiscal policies to reduce the short run negative impact on output and employment. When should monetary and fiscal policy become restrictive? These policies should "reduce aggregate spending and therefore also spending for imports" and they ensure that the exchange rate returns to the bounds established under the BW par value system (De Grauwe 1989:18).

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<sup>30</sup> This reconstruction is assisted by John Williamson's prolific work on the BW system which he believes embodied a series of assignment rules for various macropolicy instruments. See Williamson (1977, 1983, 1985). Giovannini (1993) is also helpful.

<sup>31</sup> McKinnon (1996:41) includes in his "spirit" of the BW architecture "rules" that member countries must "sterilize" the domestic monetary impact of exchange market interventions. See also De Grauwe (1989:17-18) which includes in the BW "rules of the game" an imperative that, in the case of excess demand for foreign exchange, domestic central banks must automatically conduct restrictive monetary and fiscal policy. I concur with both reconstructions though nowhere in the BW Agreement are these sterilising procedures expressly mentioned.

The BW managed exchange rate policy could retain credibility so long as reserves were sufficient. Domestic policies were vital in ensuring reserve sufficiency as Williamson (1985:74) plausibly supposed:

By the absence of alternative provisions to deal with modest non-self-reversing imbalances, one infers that the architects of Bretton Woods accepted that it would be necessary to shade fiscal-monetary policy with a view to the balance of payments position (emphasis added).

If Williamson (along with other modern commentators, McKinnon and De Grauwe) is right, then domestic monetary and fiscal policy must be conducted responsibly in the short term so as not to push up the pressure on aggregate domestic expenditure to the point where a nation's international liquidity is seriously depleted. Yet at the same time, domestic macroeconomic policy must be operated in order to attain a high level of output and employment. The 'shading' act referred to in the above passage should not be underestimated, for some tradeoff among policy objectives must be chosen. The BW architects were no doubt alive to the tradeoff problem and, within the bonds of available foreign reserves, insisted that national policymakers should have autonomy to choose a preferred tradeoff between policy objectives in the short term. With an eye to meeting their obligations under the exchange rate rule, macroeconomic policymakers could use discretion to fine tune monetary and fiscal policy; they must be policy activists. In the medium to long run, the fixed exchange rate rule had an escape clause if the short term policy 'shading' process was unsuccessful in restoring stability. In the case of deficit countries, a 'fundamental', persistent deficit warranted currency devaluation. While 'fundamental disequilibrium' is not formally defined by BW architects, "there was never much doubt" in their minds (according to Williamson) what the term meant in practice; it was a

situation in which a country could not expect to achieve basic balance over the [business] cycle as a whole without deflating output from full capacity or restricting trade or payments for balance of payments reasons (Williamson 1985:74).

Now this reconstruction makes perfect sense for a time when experiments in applying the basic tenets of Keynesian economics to policy problems were starting to take root. Exchange rates should not, in this approach, be used as an instrument of anticyclical policy to stabilise or balance the internal economy. Instead, monetary and especially active fiscal policy should be used for that purpose.

Altogether, the intellectual framework stated and implied by the BW architects amounted to much more than a commitment to the binding exchange rate rule. The set of assignment guidelines for broad categories of economic policy instruments are presented below in Table 2.1. This is a 'best guess' tabulation in keeping with the foregoing reconstruction. It represents a contrived consensus position, that is, what the BW architects were generally disposed to think about the use of certain policy instruments. The aims of policy, both domestic and international are clearly indicative in the BW Agreement and it is not made clear how domestic policy in particular might be conducted. Applying the adjective 'guidelines' to the BW Agreement is controversial for the term is not used extensively. The Agreement specifies some formal international policy rules as already noted, and these act as codes of conduct for member countries. That some rules were rather open-ended and might not have been rigorously enforceable is beside the point. While the term 'rules' is widely applied in the literature on BW, I prefer to use the softer term 'guidelines' because it has connotations entirely consistent with the BW architects' stated principle of domestic policy autonomy.<sup>32</sup>

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<sup>32</sup> Many specialists on international financial problems and monetary history since BW have used the terms 'rules', 'rule-based' and 'rule-bound' to describe the BW system. See for example, Solomon (1977:13); Bordo and Eichengreen (1993:84, 107, 117-20; 152-53) and McKinnon (1996:40).

**TABLE 2.1 Summary: BW Agreement**  
**Guideline For Policy Instruments**

Policy Instrument	Time Horizon	Primary Assignment <sup>#</sup>	Secondary Assignment	Guidelines
Exchange Rate	Short term	External balance	-	<ul style="list-style-type: none"> <li>• Binding fixed rate rule</li> <li>• Adjustable rate subject to 'fundamental disequilibrium'</li> </ul>
	Medium – long term	External balance		
Exchange Controls	Short term	External balance	-	<ul style="list-style-type: none"> <li>• Restrict short term capital flows</li> <li>• Regulate and direct capital for growth</li> </ul>
	Medium – long term	Internal balance		
Official Reserves and IMF Facilities	Short term	Exchange rate stabilisation	-	<ul style="list-style-type: none"> <li>• Draw on (or augment) as buffer for current transactions</li> <li>• Use as indicator of 'fundamental disequilibrium'</li> </ul>
	Medium – long term	External balance	-	
Monetary Policy	Short term	Internal balance	External balance	<ul style="list-style-type: none"> <li>• Use anticyclically though support sterilisation of exchange market interventions</li> <li>• Accommodate fiscal policy</li> </ul>
	Medium – long term	Internal balance	-	
Fiscal Policy	Short term	Internal balance	External balance	<ul style="list-style-type: none"> <li>• Support sterilisation of exchange market interventions</li> <li>• Maintain aggregate domestic expenditure to achieve full employment</li> </ul>
	Medium – long term	Internal balance	-	
Trade policy	Short term	External balance	Internal balance	<ul style="list-style-type: none"> <li>• Discriminate against scarce currency countries</li> <li>• Liberalise</li> </ul>
	Medium – long term	Internal balance	-	
Investment Policy	All	Internal balance	-	<ul style="list-style-type: none"> <li>• Use IBRD support if necessary, intervene in capital markets to direct growth path.</li> </ul>

<sup>#</sup> In using the shorthand expressions (i) external balance and (ii) internal balance I mean respectively:

- (i) sustainable balance over a defined time-period, usually several years in the external accounts (whereas perfect external balance occurs when a country spends and invests internationally no more than other countries spend and invest in it) and
- (ii) a high, sustainable level of domestic employment and price level stability over a defined time period, usually several years (whereas perfect internal balance occurs at full employment and changes in the general price level are low and constant),

The terms external and internal balance were not used in the 1940s. Instead of 'balance' the BW architects preferred the term "stabilisation". The term balance and stabilisation are taken as substantially equivalent in the above Table.

## CONCLUSION

Why did policymakers from 1945 need guidelines for the operation of domestic anticyclical policies and full employment policies? If they joined with policymakers from other nations and accepted the international codes of the BW Agreement, they would have an obligation not to adopt short-sighted domestic policy assignments that would undermine exchange rate commitments. As well as offering international policy guidelines, the BW discussion was underwritten by an agenda to provide an international framework for national economic policies. The fundamental normative judgement of BW architects was that member nations should be protected from themselves; that is, from the wealth-destructive consequences of individual nations engaging in competitive exchange rate devaluations and protectionist trade policies. In modern language, economic interdependencies and macroeconomic interactions among countries require some degree of mutual recognition and then cooperation over economic policy. More formal policy coordination is more likely to be successful in countries entering a BW type Agreement and if there is a transnational consensus on at least some major policy goals (Cooper 1985; Bryant 1995). The emerging doctrinal consensus circa 1944 was well-signalled in Nurkse's (1944) work and a consensus on policy was indeed discovered at BW soon after.

The place of international financial institutions in the agreed BW order is clear: the IMF and IBRD were necessary first because many elements of the BW Agreement required formal monitoring in practice. Secondly, member nations needed advice and direction. Thirdly, institutional leadership was required to effect ongoing collaboration and consultation especially on the subject of integrating domestic macroeconomic policies with BW obligations. Fourthly, member nations desired a neutral arbiter in disputations over interpreting BW principles and in the disbursement of finance from the IMF. These four functions are all necessary dimensions of any system of international cooperation whether or not concrete policies actions and formal policy coordination are undertaken within that system. In the case of the IBRD the presumption was that world capital markets were in a parlous state in 1944. In addition, capital markets exhibited significant imperfections – for instance they lacked depth and were bedevilled by poor information flows. Therefore the supply of private and government capital needed direction by a central authority. Economic

analysis and technical expertise not readily available in private markets at the time were also provided by the IBRD to reduce information problems and supposedly, therefore, increase the rationality and efficiency with which capital is allocated (Krueger 1998).

The BW Agreement undoubtedly takes as empirically confirmed the trade reducing impact of exchange rate instability. Exchange rate stabilisation is the route to domestic economic stabilisation (internal balance). Adjustment to imbalances in the external accounts should take place slowly to minimise effects on output and employment. Some semblance of internal balance is to take precedence over external balance in the short term.

The focal point of the BW conference was to find a means of central control for the international financial order in place of what the architects possibly perceived as the other extreme - a market-based, automatic mechanism which would somehow spontaneously bring together the mutual interests of various countries. BW denied two related propositions on international finance: first that deliberately designed blueprints were infeasible and secondly, that if a country chose to use domestic policy instruments responsibly according to the dictates of macroeconomic fundamentals, it could then freely join a loose, cooperative international financial arrangement.<sup>33</sup> As Keynes (1943:21) so eloquently stated, any international financial plan must:

reduce to practical shape certain general ideas belonging to the contemporary climate of opinion.....It is difficult to see how any plan can be successful which does not use these general ideas, which are born of the spirit of the age.

The overarching Zeitgeist embodied in the BW Agreement endorsed technocratic, scientific management of the international financial order.<sup>34</sup> BW represented supreme

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<sup>33</sup> No plans or blue prints were required in the latter case, just as occurred in the years when the international gold standard was in operation.

<sup>34</sup> Contemporary British economists were in the vanguard of this intellectual movement, underscoring the need to frame a grand "plan for the monetary governance of the world" (Robertson 1943:357). See also Joan Robinson (1943).

faith in conscious, rational design of international finance – precisely what Keynes had been working towards from the early 1920s (Moggridge 1986; Meltzer 1989).

For all the legalese in the BW Articles of Agreement it is striking how so much of the original BW content presents to readers as being open-ended and flexible. For example, moral suasion as much as paternalism seemed to inform the creation and operation of the IMF (Scammell 1975:122). The 'rules' for balance of payments adjustment and guidelines for domestic economic policy relied heavily on eschewing "indiscipline" and "bad-neighbourliness" (to use Keynes's 1943a:36 felicitous terms). It was as if the BW architects trusted member nations to collaborate and abide by loose rules, suspend short-term political interests, harmonise policies to achieve high growth and full employment and conduct orderly financial behaviour in the international economic realm. The impending peace process resonated beyond the contemporary military hostilities into international financial affairs; it carried with it a reservoir of goodwill and optimism.<sup>35</sup> An agreed, fruitful framework for international financial order had been established. It was a new architectural genre compared to the frame of the automatic gold standard pre-1914 the disordered gold-exchange standard system and floating exchange rate arrangements in the interwar period. Lastly, BW produced a variety of hybrid arrangements in the financial system from 1944 to the 1970s as particular events required adaptations and as interpretations of the original Agreement changed. I turn next to consider a full-blown American Keynesian reinterpretation.

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<sup>35</sup> This chapter has therefore reinforced the main finding in Cohen (1982:35): "Implicit in the original charter of the IMF was a remarkable optimism regarding prospects for monetary stability in the post-war era".