75 years of Bretton woods

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Manifest pedagogy

The current International Economic Model is based on an elaborate system of conventions and institutional arrangements. The basis for all these arrangements has been laid in the Bretton woods financial architecture established in the post war scenario. The evolution of this system is an important area in understanding the current economic exchange rate system. There is a possible question on relevance or significance of IMF and World Bank too

In news

- **Brettonwoods institutions are celebrating 75th anniversary this year**

Placing it in syllabus:

Paper 1

- World history significant events

Paper 2

- Important International institutions, agencies and fora, their structure, mandate.

Static dimensions

- Post World War economic scenario
- The Brettonwoods agreement
- The gold standard and fall of Brettonwoods system (1971 Nixon shock)
- Role of IMF and World Bank

Current dimensions

- Criticism against IMF and world Bank (structural adjustment programme)

Content

An International Monetary System is essential to incentive economic transactions, giving countries the condition to participate effectively in the exchange of goods and services, stimulating their development as trade leads to a rational use of resources and higher consumption possibilities. To be effective, an international monetary system requires an efficient balance of payments adjustment mechanism so that deficits and surpluses can be eliminated in a short time

Post world war economic scenario

The post–World War II economic expansion, also known as the **golden age of capitalism and the postwar economic boom** was a period of strong economic growth beginning after World War II and ending with the 1973–75 recession. The United States, Soviet Union, Western European and East Asian countries in particular experienced unusually high and sustained growth, together with full employment.

Globally, the golden age was a time of unusual financial stability, with crises less frequent and intense than before or after. Depopulation due to war tended to free up resources for investment and created an environment of lower competition for the survivors. Oil and commodity prices plummeted after the war, which likely led to the affordability of a suburban lifestyle. High productivity growth continued until the early 1970s. Manufacturing was aided by automation technologies.

In the post-war period, progressive taxation persisted. The real oil price was low during the post-war decades, with this ending in the 1973 oil crisis.

After the war, the major powers were determined not to repeat the mistakes of the Great Depression, some of which were ascribed to post–World War I policy errors. Structurally, the victorious Allies established the United Nations and the Bretton Woods monetary system, international institutions designed to promote stability

The Bretton Woods System

John Maynard Keynes in Britain and Harry Dexter White in the United States were the architects behind the attempt to design a new and liberal international economic order. The results of their deliberations were formalised in **The Bretton Woods Conference,** formally known as the United Nations Monetary and Financial Conference, held in Bretton Woods, New Hampshire, United States from **July 1 to 22, 1944,** in which 730 delegates from all 44 Allied nations participated. Agreements were signed that, after legislative ratification by member governments, established the **International Bank for Reconstruction and Development (IBRD) and the International Monetary Fund (IMF).**

They were formally introduced in December 1945. The **World Bank** Group, initially called the IBRD was established to **provide assistance to countries that had been physically and financially devastated** by World War II. The **main objective of the IMF was to seek stability in exchange rates.** They developed a system of pegged but adjustable exchange rates according to what was called the par (equal) value system.

Another goal of the IMF was the **reconciliation of country adjustments to payments imbalances with the national autonomy in macroeconomics policy**. Countries experiencing balance of payments difficulties were expected to approach the fund. If difficulties were deemed temporary, a loan would be provided to finance the payments imbalance until it reversed itself. Thus there would be no need for alteration of the deficit nation's macro policies in the direction of sacrificing internal goals. Further borrowing was subjected to increasingly stringent conditions which were designed to ensure that the borrowing country is taking action to reduce its balance of payments deficit.

The gold standard and break down of the Bretton Woods System

The United States held three-fourths of the world's supply of gold. The **dollar's value was 1/35 of an ounce of gold.** Bretton Woods allowed the world to slowly transition from a gold standard to a U.S. dollar standard. The dollar had now become a substitute for gold. Other countries then defined their currency in terms of dollars. As a result, the value of the dollar began to increase relative to other currencies. There was more demand for it, even though its worth in gold remained the same. This discrepancy in value planted the seed for the collapse of the Bretton Woods system three decades later.

In mid-1960s world trade was growing rapidly so was the size of payments imbalances. Gold was envisioned to be the primary international reserves asset, but reserves were not growing apace with payments imbalances. Hence the countries had to use trade and payments restrictions to reduce their deficits and these policies reduced the gains from trade and the rate of world economic growth. The dollars held by non-U.S. central banks began to exceed by a substantial margin the size of the U.S. official gold stock.

Another perceived concern was the adjustment problem. This problem refers to the fact that in the actual operations of the Bretton Woods system, individual countries had prolonged their payments imbalances. Countries directed monetary policies toward internal targets rather than external ones. Thus the contraction in the money supply expected of a deficit country did not occur, nor did the expansion of a surplus country.

In 1967, the British Pound was officially devalued as a consequence of declining U.K. foreign exchange reserves in large part due to the speculative short-term capital flows.

The devaluation was significant because the pound and the dollar were key currencies, that is, the two national currencies most prominently held by central banks as official international reserves.

The private demand for gold increased putting upward pressure on its price. This pressure could only be relieved through sales of gold by central banks. As this pressure increased, all major central banks decided in 1968 that they would no longer engage transaction with private individuals and firms. Transaction in gold between central banks would be made at the official gold price of $35 per once, but private individuals would buy and sell among themselves at whatever price cleared the private market. This new structure for gold was called the "**two-tier gold market**".

Nixon shock

The Nixon Shock was an economic policy shift undertaken by President Nixon t**o prioritize the United States' economic growth in terms of jobs and exchange rate stability.**

Nixon outlined three main goals for the plan:

- creating better jobs,
- stemming the rise in cost of living,
- protecting the U.S. dollar from international money speculators.

Nixon cited tax cuts and a 90-day hold on prices and wages as the best options for boosting the job market and tamping down cost of living. Nixon supported suspending the dollar's convertibility into gold. He proposed an additional 10 percent tax on all imports that were subject to duties. On August 15,1971, because of its continuing deficit, escalating inflation and lagging economic growth, the United States announced that it would no longer buy and sell gold with foreign central banks, thereby altering the nature of the existing monetary system. Without the gold guarantee, there was no anchor to the value of the dollar. This action amounted to an abandonment of the Bretton Woods system.

In response, the Group of Ten (G–10) industrialized democracies decided on new exchange rates that centered on a devalued dollar in what became known as the **Smithsonian Agreement.** That plan went into effect in December 1971, but it proved unsuccessful. In 1973, the G–10 implemented a strategy that called for six European members to tie their currencies together and jointly float them against the dollar. That decision essentially brought an end to the fixed exchange rate system established by Bretton Woods

Today we are dealing with free floating, market-traded currencies. This system has advantages, especially in terms of making radical monetary policies like quantitative easing possible. However, it also creates uncertainties and has led to a massive market based on hedging the risks created by currency uncertainty

Role of the IMF and World Bank

The purposes of the International Monetary Fund are as follows:

- To promote international monetary cooperation through a permanent institution.
- To facilitate the expansion and balanced growth of international trade, and to contribute to the promotion and maintenance of high levels of employment and real income.
- To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- To assist in the establishment of a multilateral system of payments in respect of current transactions and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

- To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards.
- To provide member countries with technical assistance to create and implement effective policies, particularly economic, monetary, and banking policy and regulations.

World bank comprises two institutions: the International Bank for Reconstruction and Development (IBRD), and the International Development Association (IDA). It is a component of the World Bank Group which consists of five interrelated institutions:

- **IBRD** offers loans to middle-income developing countries to promote economic development and eradicate poverty.
- **IDA** which typically provides interest-free loans to countries with sovereign guarantees.
- **International Finance Corporation (IFC)**, which provides loans, equity, risk-management tools, and structured finance. Its goal is to facilitate sustainable development by improving investments in the private sector.
- **Multilateral Investment Guarantee Agency (MIGA)**, which focuses on improving the foreign direct investment of developing countries.
- **International Centre for Settlement of Investment Disputes (ICSID)** which provides a means for dispute resolution between governments and private investors with the end goal of enhancing the flow of capital.

The current primary focus of the World Bank centers on six strategic themes:

- Poverty reduction and sustainable growth in the poorest countries, especially in Africa.
- Solutions to the special challenges of postconflict countries and fragile states.
- Development solutions with customized services as well

as financing for middle-income countries.
- Addressing regional and global issues that cross national borders, such as climate change, infectious diseases, and trade.
- Greater development and opportunity in the Arab world.
- Leveraging the best global knowledge to support development.

Criticism

In the 1980s and 1990s, the IMF along with help from the World Bank began structural adjustment programme where they provided countries with balance of payment assistance. Countries all over the world took on these programs and the results have led to impacts still affecting countries until today.

The 1979 energy crisis plunged many countries into economic crisis. The World Bank responded with structural adjustment loans, which distributed aid to struggling countries while enforcing policy changes in order to reduce inflation and fiscal imbalance. Some of these policies included encouraging production, investment and labour-intensive manufacturing, changing real exchange rates and altering the distribution of government resources.

Structural adjustment policies were most effective in countries with an institutional framework that allowed these policies to be implemented easily. For some countries, particularly in Sub-Saharan Africa, economic growth regressed and inflation worsened. E.g. in the years following the start of structural adjustment plans in Sudan, the country battled against economic depression and it became one of the largest debtors to the World Bank and IMF in 1993.

The **alleviation of poverty was not a goal of structural adjustment loans**, and the circumstances of the poor often worsened, due to a reduction in social spending and an increase in the price of food, as subsidies were lifted. Today the world’s 20 poorest countries are African and they are continuing to get poorer. Their debt has also increased tremendously.

By the late 1980s, international organizations began to admit that structural adjustment policies were worsening life for the world’s poor. The World Bank changed structural adjustment loans, allowing for social spending to be maintained, and encouraging a slower change to policies such as transfer of subsidies and price rises. In 1999, the World Bank and the IMF introduced the **Poverty Reduction Strategy Paper approach** to replace structural adjustment loans. This approach has been interpreted as an extension of structural adjustment policies as it continues to reinforce and legitimise global inequities. However the approach has not addressed the inherent flaws within the global economy that contribute to economic and social inequities within developing countries