



U.K. economist John Maynard Keynes (center) was a chief architect of the UN International Monetary and Financial Conference in 1944.

A New Bretton Woods?

James M. Boughton

History shows that reforming the international financial system requires both leadership and inclusiveness

WHEN French President Nicolas Sarkozy and British Prime Minister Gordon Brown called for a “new Bretton Woods” agreement in October 2008, they were recalling the success of the International Monetary and Financial Conference held in Bretton Woods, New Hampshire, in July 1944. What Sarkozy and Brown envisaged was a new multilateral agreement to stabilize international finance in the 21st century, the way the 1944 conference, which established the International Monetary Fund and the World Bank, stabilized financial relations among countries in the second half of the 20th century. The summit meeting of world leaders held in Washington, D.C., in November 2008 started a process that could lead to such an agreement. What would that take to succeed? What kind of leadership, and what kind of commitment, would be needed? History offers some useful lessons.

On several occasions throughout the 20th century, political leaders in major countries sought international agreements on the global economic or financial architecture. Many of those efforts failed, Bretton Woods being the major exception. The central lesson that emerges from these efforts is that successful reform in response to a crisis requires three ingredients: effective and legitimate leadership combined with inclusive participation; clearly stated and broadly shared

goals; and a realistic road map for reaching those goals.

Paris, 1918–19

A useful starting point to survey such efforts is the Paris peace conference of 1918–19, which followed World War I. Although its main purpose was to redraw political borders and to establish principles for avoiding a repeat of the war, establishing a framework for restoring free trade and the flow of capital was also on the agenda. U.S. President Woodrow Wilson provided leadership by enunciating his “Fourteen Points” as a polestar. All of the victorious allied powers were present. Although only the large countries had a significant impact on the outcome, the inclusion of the other allies lent legitimacy to the proceedings.

The economic goal of open trade and finance was widely shared, but how to achieve it was left unresolved because it was not the top priority at the conference. Agreement on a framework was scuttled by differences on war reparations, on the practical aspects of returning to the gold standard, and on the need for an international institution with oversight powers. The U.S. Congress declined to ratify participation in the new global institution, the League of Nations. A 1920 follow-up conference in Brussels established the League’s Economic and Financial Section, but its functions and

powers were limited. These failings contributed substantially to the ensuing decades of autarky, unstable financial relations among countries, and economic depression.

London, 1933

Between the wars, the most ambitious event was the World Monetary and Economic Conference, held under the auspices of the League of Nations. It was preceded by two relatively successful meetings—one in Genoa in 1922 that re-established the gold standard for a group of mostly European countries, the other in Rome in 1930 that established the Bank for International Settlements. The 1933 London conference sought to re-establish fixed parities for a wider range of currencies. As with the League of Nations, this effort failed primarily because of a lack of support from the U.S. government. Three years later, the United States did sign an accord with France and the United Kingdom on a stabilization pact known as the Tripartite Agreement. That agreement, however, was an ad hoc effort to ward off a potentially competitive devaluation of the French franc. Though successful on its own terms, the agreement lacked an institutional structure and a sustainable enforcement mechanism. It thus did little to prevent similar conflicts from arising in the future.

Bretton Woods, 1944

During World War II, the U.K. and U.S. Treasuries initiated plans to overcome the weaknesses of the piecemeal interwar approaches by establishing multilateral financial institutions for the postwar period. By mid-1942, the U.K.'s John Maynard Keynes and Harry Dexter White of the United States had prepared first drafts of their respective plans and had begun exchanging ideas to develop a common proposal before the end of the war. Preparations for what would become the Bretton Woods conference began in earnest in the middle of 1943. Keynes suggested limiting participation to a few countries, with the United Kingdom and the United States as "founder states" of the proposed institutions. This time the United States took the broader view. White insisted that delegations from all 45 allies in the war against the Axis be included and be given an opportunity to participate in the drafting sessions and in key decisions. Representatives of 18 countries met in Washington, D.C., in June 1943 to offer suggestions, and a 17-nation preparatory drafting conference was held in Atlantic City, New Jersey, in June 1944. All 45 delegations convened in Bretton Woods a few weeks later.

The singular success of Bretton Woods is attributable to the extraordinary circumstances in which it was held and to the care devoted to its preparation. Any concerns countries had about threats to national sovereignty posed by the powers given to the World Bank and IMF were effectively neutralized by the twin traumas of depression and war that characterized the interwar period. The willingness of the U.S. government to host the meeting, to take the lead in the design of the IMF, to commit itself to be the principal creditor, and to accommodate the needs of other countries (for example, by accepting the "scarce currency" clause, which imposed requirements on the dominant creditor country) was critical to the success

of Bretton Woods. The two-and-a-half-year collaboration between Keynes and White produced many revisions to the original proposals, not just to accommodate each other but also to make the design more appealing to other countries. The unanimous agreement on the Articles resulted from the careful development of a realistic plan, strong leadership from the two predominant countries, the legitimacy that came from an inclusive process, and the effect of a major crisis in stimulating the political will to act.

The planners of Bretton Woods intended to create three multilateral institutions, not two. A proposed international trade organization proved to be too politically divisive, and so a decision on it was postponed until after the war, with nearly fatal effect. As a fallback option, a group of countries established the less potent General Agreement on Tariffs and Trade in 1948. It was not until 1994 that the World Trade Organization came into being.

The end of fixed exchange rates, 1971–73

Following substantial pressures on exchange rates in the 1960s and the official termination of gold convertibility of the U.S. dollar in 1971, it became apparent that a new monetary order was needed. IMF Managing Director Pierre-Paul Schweitzer took the lead by proposing a realignment of key-currency exchange rates, including a devaluation of the dollar. The major industrial countries were divided on how to respond, and developing countries resisted being left out of the discussions. The Group of Ten (G-10) industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States) took the lead by agreeing to currency realignments at a December 1971 meeting at the Smithsonian Institution in Washington, D.C. But that agreement quickly came under strain, and the focus shifted back to the IMF. Although the G-10 could not devise a solution on its own, it did agree to the creation of the Committee of Twenty (C-20), a ministerial advisory body that at the time represented the 20 countries and constituencies of the IMF Executive Board.



Delegates at the Group of Ten talks discuss the dollar crisis in 1971.

The C-20 had the advantages of a preexisting institutional framework and secretariat and the political support of both the industrial and the developing countries. But it lacked a realistic plan for restoring stability to the payments system. The French and U.S. positions on exchange rate stability—the former wanting a return to fixed parities and the latter wanting market-determined rates—were too far apart to permit a consensus. After two years the goal of exchange rate stability was abandoned and the IMF instead was mandated to exercise “firm surveillance” over what was supposed to become a stable system through bilateral and multilateral oversight. That mandate was eventually enshrined in the Second Amendment of the IMF Articles of Agreement in 1978.

The oil-price shocks of the 1970s

U.S. Secretary of State Henry Kissinger called for a new Atlantic charter to coordinate the responses of industrial countries to the oil-price shock of 1973–74. Both the IMF and the Organization for Economic Cooperation and Development (OECD), then comprising mainly wealthier industrial economies, responded by developing proposals for a financial facility to recycle the surpluses of oil-exporting countries. The OECD plan was to create a Financial Support Fund by borrowing from oil exporters and lending to OECD member countries. With strong backing from both the United States and the major European countries, the OECD quickly negotiated a treaty establishing the support fund. But even before the OECD facility was in final draft form, the IMF had established an Oil Facility that was borrowing from oil exporters and rich countries and lending on low-conditionality terms to oil-importing countries, both industrial and developing. Political support for the OECD proposal vanished, and the treaty was never ratified.

Calls for a new Bretton Woods in the 1980s

The exchange rate system was already unstable by the time the Second Amendment took effect in 1978, and it became much more so over the next few years. On several occasions from 1982 to 1985, senior finance officials from France, the United States, and other countries called for a “new Bretton Woods,” although no one ever publicly articulated either the goals for such a conference or a road map for surmounting the failed effort of a decade earlier. Despite the high-level backing, which included French President François Mitterrand and U.S. Treasury Secretary James Baker, the proposal was never acted on. Instead, the G-5 (France, Germany, Japan, the United Kingdom, and the United States)—which had largely supplanted the G-10 as the primary steering committee for the industrial countries—acted on its own in 1985–87 to halt the five-year sustained appreciation of the dollar and then to try to stabilize rates around a new equilibrium.

Recent reforms

In 1998, the U.S. Congress took the initiative by convening the International Financial Institutions Advisory Commission, which recommended that the IMF stop making longer-term loans and write off its claims on heavily indebted poor coun-

tries that are implementing an effective development strategy approved by the World Bank. These recommendations stimulated public discussion—most importantly in the G-7 (the G-5 plus Italy and Canada) and then in the International Monetary and Financial Committee, the advisory policy-setting body of the IMF, the successor to the Committee of Twenty. Those discussions eventually resulted in the adoption of the Multilateral Debt Relief Initiative and the IMF’s Policy Support Instrument in 2005.

What we have learned

The international financial architecture over the past century evolved in response to circumstances of the moment. Formal conferences were occasionally an important element of that process. In most cases, however, institutional adaptation to changes in the world economy came from the interplay of internal deliberations and initiatives from groups of industrial countries. When problems were clearly identified and the major countries agreed on the type of solution required, deliberations within a group of those countries usually provided the necessary leadership for reform. In the most successful efforts, leadership came from a small inner group that was willing to include, listen to, and absorb ideas from a wide outer set of participants.

Each of the major attempts to revise the international financial architecture came in response to a crisis. When they succeeded, they did so only partially. This observation leads to three broader but interrelated lessons about the context in which financial and other reforms are attempted.

- It is inevitable that some important goals have to be set aside, such as the trade organization at Bretton Woods and systemic rules for exchange rates in the 1970s. Even the best “new Bretton Woods” will solve only a few problems. Whatever gets set aside is unlikely to get accomplished for another generation—or at least until the next major crisis.
- Financial crises often occur at times when other—and possibly more serious—crises are competing for attention. In the past year, the world economy has suffered a variety of ills, including a financial meltdown and wide fluctuations in the prices of food, fuel, and other basic commodities. Over the longer run, both climate change and the persistence of extreme poverty in much of the developing world are looming crises. If revising the rules of international finance dominates the agenda, the opportunity to find better ways to deal with other issues could be lost, possibly for many years.
- Decisions on which countries have a seat at the table have a major effect on what gets done and what gets set aside. Only the major participants in financial markets—industrial and emerging market countries—can devise new rules for finance, but they cannot by themselves devise new rules for trade in commodities. Nor can they cope alone with climate change or extreme poverty. The more inclusive the participation in the next Bretton Woods, the more likely the outcome will have long-run benefits for mankind. ■

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