

Rethinking the Legacy of Bretton Woods.

2021 Luigi De Rosa Lecture

on Global History

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It is a great honor to give a lecture in memory of the distinguished Neapolitan economic historian Luigi De Rosa.

Bretton Woods has become a powerful myth about how global collective action problems may be addressed. It is the only instantly recognizable location of the series of conferences of the wartime coalition (the United Nations) held shortly before and after the end of the Second World War. Hot Springs (the conference in May and June 1943 that discussed food and agriculture), Dumbarton Oaks (the meetings that sketched out a future international organization from August to October 1944) are easily forgotten; even the San Francisco conference (April-June 1945) that established the postwar United Nations system is scarcely identifiable to any but the expert in United Nations history. By contrast, the United Nations Monetary and Financial Conference, held in July 1944 at Bretton Woods, New Hampshire, is still instantly recognizable as a view of the world. It stands as the opening of a novel epoch in world history, an age of sustained recovery, widespread prosperity, dynamic growth, crisis-free development, and political stability. No wonder the memory is tinged with nostalgia, and even a longing for a repeat.

In retrospect, the Bretton Woods order looks like a solution, not just to the question of postwar reconstruction, but to the problem of recasting capitalism in such a way that it would not perma-

nently destabilize both itself and the international political and legal order. It was a technocratic solution, generating a comforting assumption that every problem has a readily available fix. As Robert Skidelsky reminds us, in consequence it has a continuing actuality.¹ What sorts of adjustment does capitalism require today?

I shall deal in turn with (1) the context and content of the Bretton Woods negotiation; (2) the analysis of the perils of globalization that lay at its core; (3) the evolution of an anti-myth of nationally oriented economics; and (4) the new challenges that demand a renewal of the global institutional framework.

I. The Context of Bretton Woods

There is a hero – John Maynard Keynes – and then as we will see an anti-hero – Richard Nixon. Any contemplation of the long-term lessons of Bretton Woods has to begin with the godlike (the phrase is Lionel Robbins's, not mine) figure who presided over it.² Bretton Woods was about reconstruction, but not simply about reconstruction after a War or about trying to return to the prewar order. The conference continued a debate about the appropriate form of an international economic order that had already started in the War, as a competition of contrasting systems. When in 1940 the German Minister of Economics, Walther Funk, presented a plan after the fall of France and at the height of German euphoria about a Nazi "New Order," the British government asked John Maynard Keynes to prepare a counter-scheme. Funk had presented his plan as an alternative to the out-dated and discredited gold standard; Keynes insisted that any response could not offer reconstruction as it had been done after the First World War. He wrote that it would not be enough to restore "good old 1920-1921 [the postwar slump] or 1930-1933 [the

¹ Robert Skidelsky, *Keynes: The Return of the Master*, Public Affairs, New York, 2009.

² For Lionel Robbins' description of the "godlike" Keynes, Roy F. Harrod, *The Life of John Maynard Keynes*, Penguin, Harmondsworth, 1972, p. 740; also Donald Moggridge, *Maynard Keynes: An Economist's Biography*, Routledge, London, 1992.

Great Depression], i.e. gold standard or international exchange laissez-faire aggravated by heavy tariffs, unemployment etc. etc.”³ He did not want the solution that the United States preferred, extensive trade liberalization, as that would simply open up other, less competitive, economies to a renewed onslaught of the forces of depression. Bretton Woods was about reconstructing a system that had not been adequately reconstructed in 1919. But how could a world order, that had evolved rather than being created spontaneously, be negotiated by different powers that wanted to protect their national interest?

Keynes had a powerful reputation as a critic of counter-productive or destructive attempts at international cooperation: of the Paris peace conference of 1919, but also of the attempts to deal with depression in the early 1930s. In 1933, Keynes had commented on the abortive London World Economic Conference that a pow-wow of sixty-six nations could never be expected to agree. A workable plan could only be realized at the insistence of “a single power or like-minded group of powers”.⁴ He knew he had to woo the United States. In 1919, in *The Economic Consequences of the Peace*, he had written plaintively: “But if America recalls for a moment what Europe has meant to her, what Europe, the mother of art and knowledge, in spite of everything, still is and still will be, will she not reject these counsels of indifference and isolation, and interest herself in what may be decisive issues for the progress and civilization of all mankind?”⁵ Was the turn in 1944 to a different postwar policy to that of 1919 a consequence of new power politics, or a new and superior

³ Walther Funk, *The Economic Future of Europe*, Terramare Office, Berlin, 1940; Armand van Dormael, *Bretton Woods: Birth of a Monetary System*, Holmes and Meier, New York, 1978, pp. 6-7; Joseph Gold, *Legal and Institutional aspects of the International Monetary System: Selected Essays*, Volume 2, IMF, Washington, 1984, p. 19; Donald Moggridge, *Maynard Keynes: an Economist's Biography*, Routledge, London, 1992, p. 654.

⁴ Cited in Robert Skidelsky, *John Maynard Keynes: The Economist as Saviour*, Macmillan, London, 1992, p. 482.

⁵ John Maynard Keynes, *The Economic Consequences of the Peace*, Macmillan, London, 1919, p. 268.

intellectual direction that overcome American isolationism? Was the key to success American power, or was it rather that Keynes's powerful intellect that brilliantly confined and circumscribed the possibilities of applying American power? Or is there another possibility: was it being able to count – to prepare an overview of economies that highlighted policy issues?

Bretton Woods became a possibility because of a technology for knowing and thinking about economics that had not previously existed: national income accounting. A foundation had already been laid in the 1930s, with the report presented to Congress in 1939 by Simon Kuznets on *National Income, 1929-35*. The Cambridge statistician Colin Clark inspired Keynes to apply national accounts to a consideration of the wartime economy.⁶ After a controversy touched off by an *Economist* article on national income that implied a sharp rise of inflation, and on the urging of Keynes, Richard Stone and James Meade prepared a White Paper entitled "An Analysis of the Sources of War Finance and an Estimate of the National Income and Expenditure in 1938 and 1940."⁷ In 1942, they went on to publish a short tract, *National Income and Expenditure*, with calculations for the US and the UK. The result laid the basis for wartime planning. But the calculations, Stone explained, when setting out the goals of the new Cambridge University Department of Applied Economics, would ultimately "increase human welfare by the investigation and analysis of economic problems of the real world."⁸ The techniques used by Stone could not easily be applied to very poor countries; but trying to apply them highlighted the problem of inequality and the policy failures that had produced it.⁹ The war also brought a new

⁶ John Maynard Keynes, *How to Pay for the War*, Macmillan, London, 1940; Angus Maddison, "Quantifying and Interpreting World Development: Macromasurement Before and After Colin Clark", in *Australian Economic History Review*, 44, 1, 2004, pp. 1–34.

⁷ The Future of Spending, *The Economist*, February 1, 1941, p. 138; Skidelsky, *Keynes*, pp. 83–84.

⁸ M. Hashem Pesaran and Geoffrey C. Harcourt, "Life and Work of John Richard Nicholas Stone 1913-1991", in *The Economic Journal*, Feb. 2000, Vol. 110, No. 461, p. F149.

⁹ Daniel Speich, "The Use of Global Abstractions: National Income Accounting in the Period of Imperial Decline", in *Journal of Global History*, 6(1), 2011, pp. 7–28.

interaction of economics and managerial problems as applied in Operations Research.¹⁰

Applying the new methods required political support. Bretton Woods was obviously a unique occasion, whose magic was produced in part by the felicitous timing: just after the Normandy landings, when the prospect of a very speedy end to the European conflict appeared much greater than in reality it proved to be. Treasury Secretary Henry Morgenthau told a strategy meeting preparing for Bretton Woods quite candidly that: “we felt that it was good for the world, good for the nation, and good for the Democratic Party, for us to move.”¹¹ Why was what was good for the Democratic Party really what good for America or the world?

Was this naked power masked as idealism? There were three specific lessons, in all of which idealism was tempered by a precise calculation of the balance of national interest: in trade relations, in internationalizing the New Deal, and in addressing the question of capital mobility.

1. *The Trade Lesson*. The Bretton Woods conference represented both an attempt to learn the lessons of the Great Depression (in the mind of the Democratic Party, i.e. of the New Deal), and a part of the preparation for peace and the postwar order. Destructive disputes over trade could be overcome by an agreement on monetary matters.

The principle of the obligation to introduce currency convertibility, limits on discriminatory trading practices, and increased access to each other’s markets had been inserted into Anglo-American relations as Article VII of the Lend-Lease agreement, which was generally known as “the Consideration” and was regarded by Keynes with considerable bitterness. The original draft of the State Department specified that the two countries would commit themselves to “promote mutually advantageous economic relations between them and the betterment of world-wide economic relations; they shall pro-

¹⁰ Philip Mirowski, “Cyborg Agonistes: Economics Meets Operations Research in Mid-Century”, in *Social Studies of Science*, Oct. 1999, Vol. 29, No. 5, pp. 685-718.

¹¹ John Morton Blum, *From the Morgenthau Diaries*, Vol. 3, *Years of War 1941-1945*, Boston, Houghton Mifflin, 1967, p. 248.

vide against discrimination in either the United States of America or the United Kingdom against the importation of any product originating in the other country." The measure appeared in Washington as a sledgehammer to break the carapace of British Imperial Preference. The same language was used in Clause Four of the Atlantic Charter, drawn up in shipboard meetings on the ocean at the first visit of Winston Churchill to Roosevelt. The governments committed themselves "to further the enjoyment by all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world."

The uncompromising attitude of the United States on trade liberalization brought the inescapable conclusion even to opponents and skeptics (such as Keynes) that trade liberalization could not be the subject of discussion or bargaining. The British may have suspected that the U.S. intention was to impose free trade on other countries so that there would be ready markets for the powerful manufacturing machine, but that Congress would still maintain some domestic protection. So Keynes was eager to move ahead at the time of Bretton Woods with some kind of mechanism in the form of an International Trade Organization to ensure that the United States too was constrained. How fortunate for the world that there were no trade negotiations! When after the conclusion of the War, countries started haggling about the exemptions they desired from a proposed International Trade Organization, the United States Congress indeed revolted, and the proposed institution collapsed. Bretton Woods in this sense had already succeeded before the delegates even met because of the already established wartime consensus that trade should not be debated, and thus that an initial conference should deal with currency stabilization. The order was already embedded in pre-existing diplomacy.

2. *The New Deal Context*: Very different types of economy needed to be integrated in the common vision: ones that relied (as would the UK and the US) on Keynesian macro-economic demand management; as well as economies with central planning, including of external trade, on the Soviet model. The Soviet delegation was a part of

Bretton Woods, and some of the obscurer wording of the Agreement is the result of the need to take into account Soviet peculiarities.

How could domestic priorities be reconciled with peace and broad international objectives? There were three alternative possibilities:

1. States might come to see their selfinterest as lying in international harmony. The experience of the 1930s however did not seem encouraging.
2. An international juridical framework might be established for economic issues to arbitrate in cases where national and international objectives clashed.
3. An entirely automatic mechanism might point states in the direction of peace and prosperity without a complex and lengthy bureaucratic or juridical process.

Discussions of the postwar order swung between acceptance of the second and third of these choices, and ended by taking elements of both. Both relied on the availability of accurate statistical information. Article VIII/5 of the IMF Articles of Agreement (“General Obligations of Members”) include a long list of data as the “minimum necessary for the effective discharge of the Fund’s duties” that included gold holdings, gold production, the international balance of payments, and national income (viii).

Automatism was attractive because it was apolitical; but it might not always fit in with widely perceived needs. An element of discretion was needed, which might best be provided through the creation of an institution with legal powers established by treaty. Keynes in preparing for Bretton Woods seems to have thought in terms of the allocation of a single goal to a single instrument: national governments would ensure full employment through their fiscal policy; the IMF would supervise balance of payments adjustment; an International Trade Organization would promote international trade; and the World Bank would push development.¹² The resulting compro-

¹² See David Vines, “John Maynard Keynes 1937-1946: The Creation of International Macroeconomics”, in *Economic Journal*, 113, 2003, F346. I owe this reference to Professor Paola Subacchi’s excellent comment on the lecture.

mise is the foundation of the Bretton Woods achievement. Unfortunately, however, each of these actions had implications for other institutions: the pursuit of full employment would affect the balance of payments; and the exchange rates managed by the IMF would have to respond to unfair trade or trade imbalances.

3. *The Intellectual Context*: Keynes did not believe in what might be called the “globalization paradigm”: the theory, elaborated already by Montesquieu and celebrated by Richard Cobden and John Bright as well as by Norman Angell that commerce and commercial inter-connectedness would by themselves bring international peace and order. In the *Economic Consequences of the Peace* he had written: “Bankers are used to this system, and believe it to be a necessary part of the permanent order of society. They are disposed to believe, therefore, by analogy with it, that a comparable system between Governments, on a far vaster and definitely oppressive scale, represented by no real assets, and less closely associated with the property system, is natural and reasonable and in conformity with human nature. I doubt this view of the world. Even capitalism at home, which engages many local sympathies, which plays a real part in the daily process of production, and upon the security of which the present organisation of society largely depends, is not very safe.”¹³

The Bretton Woods scheme depended on a worldwide agreement on the control of capital movements, which was presented as a “permanent feature” of the postwar system.¹⁴ The Union would work closely not only with an agency dedicated to stabilizing prices (in order “to control the Trade Cycle”), but also with a supranational peacekeeping agency (“charged with the duty of preserving the peace and maintaining international order”). The British draft concluded that the proposal was “capable of arousing enthusiasm because it makes a beginning at the future economic ordering of the world between nations and the ‘winning of the peace’, and might

¹³ Keynes, *Economic Consequences*, pp. 263-4.

¹⁴ Horsefield, *International Monetary Fund*, III, p. 13.

help to create the conditions and the atmosphere in which much else would be made easier.”

A new consensus on the causes of the Great Depression had shifted the emphasis away from the favorite villains of the 1930s literature the uneven distribution of gold and the sterilizing policies of the Banque de France and the Federal Reserve System, or the allegedly excessive monetary inflation of the 1920s, or structural weaknesses in major industrial centers. Rather the new view looked at the transmission process of depression, and came to the conclusion that the large short-term capital flows of the 1920s and 1930s had led to disaster. These movements had made it impossible for states to pursue stable monetary policies, they threatened exchange rate stability, and they made fiscal stabilization highly hazardous.

II. The Analysis of Globalization: Trilemmas

Capital movements, however, turned out to be hard to suppress or control. They were often initially hidden in trade financing, as leads and lags of payments. Debates about the weaknesses of Bretton Woods, and then later about whether a new version of Bretton Woods could be applied in the regional setting of the European Monetary System after 1979 revolved around an inconsistent trinity famously identified by Robert Mundell: Fixed exchange rates, capital mobility, and independent monetary policies are inconsistent with each other.¹⁵ The presence of capital mobility in a fixed rate regime makes it impossible for countries to set their own monetary policies or determine their own monetary preferences. As applied to Bretton Woods, Mundell’s interpretation emphasizes the frustration of some of the growing export economies about rising levels of inflation that were interpreted as being imported from the United States.

¹⁵ Robert A. Mundell, “Capital Mobility and Stabilization Policy under Fixed and Flexible Exchange Rates”, in *Canadian Journal of Economic and Political Science*, 29(4), 1963, pp. 475-85; Tommaso Padoa-Schioppa, “The European Monetary System: A Long-Term View”, in Francesco Giavazzi, Stefano Micossi, Marcus Miller (eds.), *The European Monetary System*, CUP, Cambridge, 1988.

Later Tommaso Padoa-Schioppa reformulated Mundell's proposition as the "inconsistent quartet" of policy objectives by bringing in commercial policy, another central part of the globalization package: free trade, capital mobility, fixed or managed exchange rates, and monetary policy independence. In both the Mundell and Padoa-Schioppa formulations, the impossible choice provided a rationalization for building a more secure institutional framework to secure cross-border integration, especially to deal with the problem of small or relatively small European countries. Both economists were major architects of the process of European monetary union. They justified this step of further integration on the grounds that the exchange rate was a useless instrument – the monetary equivalent of a human appendix or tonsils – that could be usefully and painlessly abolished. However, some countries continued to regard the exchange rate as a useful tool for obtaining trade advantages.

The policy constraint following from free capital movements has recently been posed in a more severe form by H el ene Rey, who shows that in a globalized world of free capital movements, monetary policy is limited even with flexible or floating exchange rates.¹⁶ A choice to have a floating exchange rate thus does not give a free pass to monetary policy. Rey identifies "an 'irreconcilable duo': independent monetary policies are possible if and only if the capital account is managed, directly or indirectly, via macroprudential policies." This argument does not necessarily lend itself to the demonstration of the necessity of monetary union: If the aim is to preserve national policy autonomy, a better choice is to control capital movements, as was envisaged in the 1944 Bretton Woods Conference and provided for in the Articles of Agreement of the International Monetary Fund. Capital movement across borders – through both inflow surges and the consequences of reversals – may fundamentally limit the scope of national monetary policy. Since the 2008 global financial crisis, the articulation and elaboration of macroprudential policies

¹⁶ H el ene Rey, "Dilemma not Trilemma: The Global Financial Cycle and Monetary Policy Independence", Jackson Hole Presentation, August, 2013.

has become a way of trying in practice to limit or manage the extent to which capital may be mobile; consequently, the discussion of the monetary policy trilemma leads in a straightforward way to the discussion of financial policy issues.

Capital mobility, however, continues to be attractive. Financially constrained borrowers – corporations as well as governments – see capital inflows as a way of obtaining access to financial resources. In addition, the inflows may be linked to institutional innovation and governance reform. After waves of overborrowing, the costs may be clearer: capital flows, in the neat analogy of Stiglitz, generate such large waves as to upset the delicate rowing boats of small countries afloat on the sea of globalization.¹⁷ But many participants in the process quickly forget the possibility of the large waves and tides.

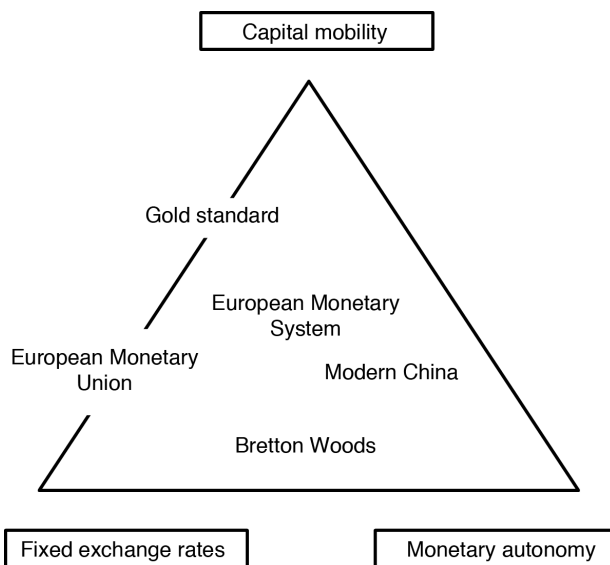
The logic of the original Mundell trilemma thus points either in the direction of closer cooperation (including perhaps political arrangements that constrain domestic choices) or toward capital controls as a way of rescuing national policy autonomy. In light of the gains that may be lost as a result of capital controls (and of an awareness of the necessarily incomplete character of capital controls that makes them prone to evasion), the process of globalization points in the direction of a need for cooperation and coordination. But the policy solutions are not in the corners or on the sides of the triangle of options, but rather in the middle: there is never complete capital mobility, or immobility; exchange rates are never completely fixed (even a currency union in theory allows exit); and monetary policy is informed by news from abroad.

There exists another well-known trilemma, concerned with political economy, and most famously described by Dani Rodrik.¹⁸

¹⁷ Joseph Stiglitz, “Boats, Planes and Capital Flows”, in *Financial Times*, March 25, 1998.

¹⁸ See Dani Rodrik, “The Inescapable Trilemma of the World Economy”, 2007, http://rodrrik.typepad.com/dani_rodriks_weblog/2007/06/the-inescapable.html; Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy*, Norton, New York, 2011; Michael D. Bordo and Harold James, “The trade-offs between macroeconomics, political economy and international relations”, in *Financial History Review*, 26(3), July 2019, pp. 1-20.

FIGURE 1
The Macroeconomic Trilemma



After a period of financial opening, the consequent development of financial imbalances may strain the political system. States (whether they are autocracies or democracies) initially like the benefits of open capital markets. Democracies, in which governments are responsive to the short-term demands of voters, are also likely to want to set monetary policy independently. They need to work out a trade-off between present monetary autonomy and the ability to attract inflows. In addition, both policies have time consistency problems of a different character. First, the monetary stimulus will bring immediate benefits only if it is unanticipated; if there is an expectation that the behavior will be repeated, agents will build the future into their responses to the stimulus. The stimulus relies on the noncontinuation of the policy. Second, by contrast, capital inflows may also bring short-term effects, but if there is a sudden stop, investment projects will remain unfinished and repayment will be problematic. The benefits rely on the expectation that the flows will continue. But states, especially democratic states, find it hard to commit to policies

that will lock in the institutional basis on which long-term inflows can occur; there is instead an incentive to derive simply short-term advantages (such as those following from monetary stimulus) and leave the longer-term problems to successor governments.

While capital inflows continue and the financial imbalances build up, the system looks as if it is politically attractive and stable. Indeed, political parties often make compromises to support governments that can promise the institutional reforms needed to allow the inflow of capital to continue. Because inflows are generally the result of external financial conditions, they should not be interpreted as a response to particularly suitable or well-designed economic policies; but that is how they are commonly interpreted by voters, who view economic success as a key determinant in their choice.¹⁹ In practice, large inflows may weaken effective economic policymaking, because they relax the constraints under which governments operate and because the generally rising tide means that signals are suppressed that might indicate problematic features of the economy.²⁰ Capital flows thus may suppress basic signals about government effectiveness that are essential to the functioning of democracy, because voters are not correctly informed about the level of competence of their governments. Warning against the potentially deleterious effects is a business that is unattractive, and left to outsiders, who make Cassandra-like prophecies. The insiders who benefit from inflows can in aggregate behave to ridicule the Cassandras.

However, when financial strains appear as a result of capital account openness, political parties no longer wish to be associated with the consequences. Voters blame the parties that have been associated with power for their past mistakes and flock to parties that define themselves as being against the system. In modern parlance, these parties are often described as “populist.” The populist parties

¹⁹ Mark Andreas Kayser, “Partisan Waves: International Business Cycles and Electoral Choice”, in *American Journal of Political Science*, 53 (4), 2009, pp. 950-970.

²⁰ See Jesús Fernández-Villaverde, Luis Garicano, Tano Santos, “Political Credit Cycles: The Case of the Eurozone”, in *Journal of Economic Perspectives*, 2013, 27(3), pp. 145-66.

may be on the left or on the right; in fact, most anti-system parties combine elements of a left-wing and a right-wing critique of the system they are trying to overthrow. The left-wing critique is that the burden of crisis adjustment of incomes and wealth falls unequally and unfairly on the poor. The right-wing critique emphasizes that the adjustment works to the benefit of foreign creditors and represents a derogation of national sovereignty. These opposing arguments are not really contradictory; they can be (and are) easily combined. In these circumstances, the democratic principle is simply recast as a defense of national sovereignty.

Examples of the disintegration of traditional party systems in the aftermath of severe financial turbulence can be found in twentieth century history and in story of the European debt crisis. The Great Depression produced disintegration of democratic systems in central and eastern Europe and Latin America. The iconic case of democratic failure is that of Weimar Germany, which had a constitution and political system that had been carefully designed by distinguished political theorists (notably Max Weber and Hugo Preuss) to be as perfect a reflection as possible of popular voting preferences: the system featured both a direct election of the president and proportional representation designed so that there would be no “lost” votes. However, the parties committed to democracy progressively lost voting shares, and the parties associated with government lost especially badly. By the time of the Great Depression, both the center-left (the Social Democratic Party) and the center-right (the Democratic Party and the German People’s Party) had lost significantly and were no longer capable of commanding a parliamentary majority. In terms of policy, the governments could do little, and their policy options were profoundly limited (Borchardt 1991). The disintegration of system parties in the face of economic constraints was also a key element in the modern financial and political crisis in Europe.

In hard times – when politicians demand sacrifices from their voters – they often explain their position by saying that their hands are tied. While that may be a plausible argument in very small coun-

tries, the larger the country, the less compatible this stance is with the idea of national sovereignty. Consequently, the demand for an enhanced national sovereignty appears as a frequent response to setbacks, and even small countries may rebel. As Greece's flamboyant, radical finance minister Yanis Varoufakis put it in 2015, "The notion that previous Greek governments signed on the dotted line on programmes that haven't worked, and that we should be obliged to just follow that line unswervingly, is a challenge to democracy."²¹

The demand for national policy autonomy affects the policy equilibrium that arises out of the first trilemma. But when monetary independence could lead to the possibility of short-term stimulus at the cost of longer-term credibility, such autonomy would be undesirable. Monetary independence would lead to political pushes to manipulate monetary policy for short-term advantages without providing any long-term gains. The Mundell trilemma in these circumstances points in the direction of constraining national monetary autonomy. If the outcome of a likelihood of turning to a more national monetary policy is known in advance, it will influence investors' calculations. They will see commitment to a gold standard or fixed exchange rate regime as ultimately lacking credibility.

The memory of the politics of turning against creditors during the Great Depression faded as the credit super-cycle emerged in the second half of the twentieth century, when the argument began to resurface about the compatibility of globalization with democracy in emerging markets.²² Rodrik formulated the point in this way as a general argument about the incompatibility of hyperglobalization, democracy, and national self-determination: "democracy, national sovereignty and global economic integration are mutually incompatible." He also presented the European Union as the best template of a new form of global governance with supranational rulemaking.

²¹ *Financial Times*, February 2, 2015, "Greece Finance Minister Reveals Plan to End Debt Stand-off".

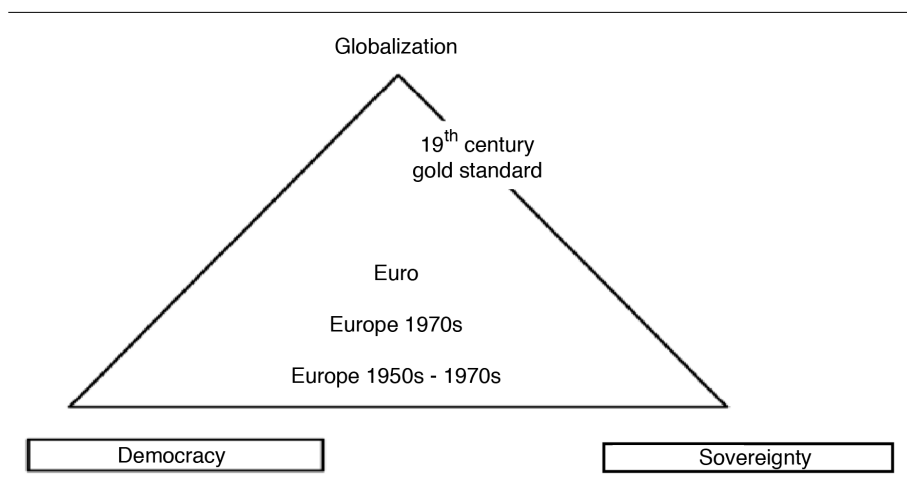
²² Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System*, Princeton University Press, Princeton, New Jersey, 1996.

After the global financial crisis, the same problems and policy dilemmas appeared in rich industrial countries, and globalization appeared vulnerable again.

Democratic politics can be thought of as evolving two sorts of operation: the formulation of laws based on general principles of conduct, and redistribution of resources. The capacity to redistribute is limited if there is a large cross-border mobility of factors of production: capital is most obviously mobile, and it escapes if rates of capital taxation are too high; but the same process may also hold true in the case of taxation of high incomes, and income earners will try to operate in a different national and tax setting. Even the capacity to formulate general laws may be limited, in that incompatible principles in different countries may produce anomalies or loopholes and possibilities for forum-shopping. Again, the sustainable policy choices will lie in the middle of the triangle.

Democratic politics will not work when too many promises are made. Realistic democracy involves a commitment to longer-term sustainability. Sustainability is always threatened by rapid changes of policy or by policy inconsistency. Some commentators identify a fundamental “economic policy problem.” Democratic societies find

FIGURE 2
The Political Economy Trilemma



credible commitment to a long-term policy almost impossible, even with a broad consensus that such a long-term orientation would be desirable. Political scientists point out that no adequate mechanisms exist to reward current majorities for future economic performance; that is, policies that entail a current cost with payoffs that do not occur until several electoral terms in the future.

Considering a broader concept of democracy in an international setting reduces the political logic of a zero-sum-game mentality in which one country's gains can be achieved only through losses imposed on others. A larger security umbrella can therefore provide a framework for a system of rules about capital movement and a framework for stability that would limit or circumscribe the destructive capacity of capital-inflow-fueled credit booms.

But such grand compacts (of which the best historical example is Bretton Woods) are hard to achieve without a substantial amount of fear and uncertainty. The equivalent today of the time pressure that existed at the end of World War II is an urgent but also uncontrollable global crisis. The sad lesson of Bretton Woods (and the strains that it produced) is that things need to be extremely dangerous before a political dynamic of reform develops.

III. The Negative Nixonian Myth (the Nattering Nabob of Negativity)

Any good myth also has an anti-myth, with a story of the assertion of politics and the destruction of order. It took a long time for anything like the Bretton Woods system to come into operation. The right in the United States was hostile, and American bankers lobbied against the Bretton Woods agreements, which they saw as costly concessions to foreigners and to socialist and redistributive principles. For them, there was too much of the New Deal in the scheme. In the United Kingdom, the agreements were attacked by economic nationalists both on the left of the Labour Party, and on the right of the Conservative party. For these politicians, the scheme was simply

too American. The attempt to impose convertibility on Britain rapidly proved to be a fiasco in July 1947. The U.S. administration took a different path to European reconstruction with the European recovery program (or Marshall Plan), whose administration was deliberately not entrusted to the IMF, but rather to the Basel-based Bank of International Settlements (BIS), a relic of the interwar years of bankers' diplomacy which the New Dealers hated, and whose termination had been provided for in the Bretton Woods agreements. The European Payments Union, administered through the BIS, was a clearing mechanism restricted to Europe, and institutionalizing discrimination against the dollar.

The major European economies only restored current account convertibility, in line with the requirements of Article VIII of the International Monetary Fund's articles of agreement after 1958, and Japan in 1964. By 1968 the par value system was in obvious crisis, and between 1971 and 1973 it broke down. Despite the fact that it only "worked" for a few years, it is held to constitute a success. Something like a modified capitalist order was indeed reestablished. Then the dangers reappeared once more.

Richard Nixon in 1971 embraced a mendacious narrative of economic nationalism that has haunted, and damaged, the United States ever since: it shaped a new approach to money, without dethroning the US dollar. Nixon explained in 1971 that the world "urgently needed a new international monetary system." Privately he asked, "Goddam it, my view is why be bound by all that stuff in the past?"²³ Nixon's move was more than just a personal whim, directed to trying to secure his reelection in 1971: it highlighted a flaw in the Bretton Woods compromise, in that if a country wanted to push national fiscal policies to the end of securing full employment, it would have consequences for its own balance or payments but also for those of its trading partners and the rest of the world.

Nixon's announcement in the television address of August 15,

²³ John A. Farrell, *Richard Nixon: The Life*, Doubleday, New York, 2017, p. 875.

1971, was, as he intended, game-changing. But not at all in the way that Nixon imagined or promised. He started his televised address with the observation that: “Prosperity without war requires action on three fronts: We must create more and better jobs; we must stop the rise in the cost of living; we must protect the dollar from the attacks of international money speculators.”

The American President did indeed, eventually, end the long war in Vietnam, perhaps the prime driver of the increasing American malaise. But instead of creating more jobs, the end of the par value system (Bretton Woods) produced a decade in which unemployment soared and manufacturing jobs were lost; inflation increased dramatically rather than falling; and international capital markets (aka international money speculators) had a bonanza. Far from being repelled as a result of government action, they took over the American economy.

It wasn’t just a bad prophecy or prediction. Nixon’s speech was full of a dishonesty that was starkly apparent at the time. Fed chair Arthur Burns asked himself, “are we going to build a new world in sheer bluff and bombast.”²⁴ The President assured: “Let me lay to rest the bugaboo of what is called devaluation. If you want to buy a foreign car or take a trip abroad, market conditions may cause your dollar to buy slightly less. But if you are among the overwhelming majority of Americans who buy American-made products in America, your dollar will be worth just as much tomorrow as it is today. The effect of this action, in other words, will be to stabilize the dollar.”²⁵ Nixon was uncannily echoing another persistently mendacious political leader, Britain’s Harold Wilson, who had told the British public after the 1967 devaluation of sterling that: “From now on, the pound abroad is worth 14 per cent or so less in terms of other currencies. That doesn’t mean, of course, that the Pound here in

²⁴ Farrell, *Nixon*, p. 877.

²⁵ Richard Nixon, Address to the Nation Outlining a New Economic Policy: “The Challenge of Peace,” August 15, 1971, at <https://www.presidency.ucsb.edu/documents/address-the-nation-outlining-new-economic-policy-the-challenge-peace>.

Britain, in your pocket or purse or in your bank, has been devalued.”²⁶ That pronouncement too had been subjected to immediate ridicule, as the effect of devaluation on import prices was even more apparent in Britain, as a smaller and more open economy.

There were also parallels in the repercussions of the 1967 and the 1971 currency moves. The devaluation of the world’s second reserve currency, the British pound, set the stage for increasing nervousness about the future of the dollar as the world’s central reserve currency.

The Nixon speech was a rejection of any multilateral solution of the exchange rate issue – the IMF had been preparing recommendations on a new structure of exchange rates, but it was ignored. It also set about the demonization of capital markets: “Now who gains from these crises? Not the workingman; not the investor; not the real producers of wealth. The gainers are the international money speculators. Because they thrive on crises, they help to create them.”

As the crisis of Bretton Woods was building up, the Canadian economist Robert Mundell again formulated a response in a remarkable essay, with three big – and for the late 1960s completely surprising – predictions.²⁷ They turned out to be spot on. The dollar would remain the world’s leading currency for the foreseeable future; Europe would get a single currency; and the Soviet Union would disintegrate. Mundell’s trinity proved a much more successful act of prophecy than Nixon’s hope for job creation, no inflation, and curtailing international speculation. The prophecies were interconnected. It was the new dynamism of the capital markets and of American banking (operating increasingly offshore) that ensured the continuing preeminence of the dollar. Worries about the international position of the dollar, especially when the currency was weakening, in the late 1970s, the late 1980s, and the early 1990s) provided

²⁶ Broadcast address, November 19, 1967, at http://news.bbc.co.uk/onthisday/hi/dates/stories/november/19/newsid_3208000/3208396.stm.

²⁷ Robert Mundell, “The International Monetary System and the European Region”, in Alexander Swoboda (ed.), *L’Union Monétaire en Europe*, HEI, Geneva, 1971.

a decisive push to Europe to institutionalize closer currency cooperation. The need of the Soviet Union to access international capital markets in the late 1990s accelerated the process of dissolution.

The immediate effect of Nixon's price controls was to encourage more consumption, more imports, and eventually there were shortages, especially of heating oil in the winter of 1972-3. The chronology of descent into scarcity matters because a great deal of the mythology of the 1970s arose from the claim the rest of the world – in particular the oil producers, but also other commodity suppliers – had abused their position. Americans continued in Nixon's vein: blaming foreigners for a domestically produced disorder, driven by a combination of loose fiscal policy and politically motivated monetary policy. In reality, of course, the rest of the world was responding to developments driven by the US – and by the many other western countries that had embarked on the same course of self-confident expansion.

There might have been a new stable multilateral system of exchange after the December 1971 Smithsonian meeting, but Nixon was unwilling to take his feet off either the monetary or the fiscal pedals, as he was fixated by the 1972 election and the need to maintain an economy running hot in order not to risk election defeat. Instead, an ad hoc non-system, to use the neat phrase of the late John Williamson, emerged. The world suffered not only from "the innate conservatism of the international financial establishment," but more significantly from what Williamson termed the absence of a "better theory," or a "widely acceptable alternative."²⁸

Over the years since 2008, the center of the non-system, the dollar, is gradually eroding. We have come a long way from the unipolar moment of the 1990s. Doubts about the dollar were raised by another unpopular and ill-judged war, the 2003 invasion of Iraq; by another financial crisis in 2007-8; and by the increasing weaponization of the dollar as an instrument of geopolitical coercion. Juan

²⁸ John Williamson, *The Failure of World Monetary Reform, 1971-74*, New York University Press, New York, 1977, pp. xiii, 182.

Zarate, one of the architects of the specific plan to use financial sanctions in the 2000s, correctly noted that it was a highly successful instrument against North Korea, but that it would be less effective and possibly counter-productive when applied to more internationally connected economies, Iran or Russia.²⁹

After the bitterly divisive election of 2020, with the very tight Senate race and the prospect of a possible blowback in 2022 (a repeat of Obama's 2012 "shellacking"), the administration is making a calculation analogous to the Nixon calculation in the leadup to the 1972 election. Fiscal and monetary stimulus can be pushed simultaneously on a scale unprecedented in peacetime because of the unique position of the dollar, the only currency to have a true monetary sovereignty.

The centrality of the US to everyone else's discussions of global governance may look to some optimists in Washington as if it must inevitably persist, and that the worst that could happen from a resurgence of inflation would be an episode of dollar depreciation followed by rebalancing, similar to that of the Carter presidency in the late 1970s. After all, the US provides two common goods that everyone still, for the moment, needs, the English language as a common medium of expression, and the American dollar as a common medium of exchange. The dollar and its central role are the still lasting legacy of Bretton Woods. Will those American advantages endure even after the relative decline of America's share in the world economy, the rise of big new economic powers, the fragility of the international order, and the increased push (even with new administration) to disengage from the world?

Both language and dollar are now under threat. The past years have seen enormous advances in automatic translation.

And what about money as a translator of wants and needs? There are already warnings: the 2020 liquidity strains in the Treasury market, the weak foreign demand for Treasury securities. The long

²⁹ See Juan C. Zarate, *Treasury's War: The Unleashing of a New Era of Financial Warfare*, PublicAffairs, New York, 2013.

preeminence of the dollar is under challenge, but not primarily from other currencies – though both the Euro and the renminbi may well be bolstering their attractions as claimants to the throne of the dollar. The national era in money is drawing to a close at the same time as a technological revolution gives radically new methods of addressing the problem of a cross-border monetary language.

One consequence of the new possibilities is the unbundling of the apparently solid historical link between money and monetary stability and government fiscal management. Experiments to tackle the economic fallout from Covid through large central bank stimulus programs, promised for long time periods risk a new vulnerability and raise inflationary dangers. It is likely that the world will demand a new monetary revolution; and at the same time, the means for that revolution is supplied by the way loose monetary policy pushes flows into alternative asset classes.

As money is unbundled into different functions, with new platforms of exchange, where is innovation most likely to occur? One prediction would be that the innovation would occur where states are weak and not trusted, and consequently state promises are not seen as highly credible. In rich and well-developed industrial societies there is another logic. Where the promise of social cohesion means less, being able to separate peacefully into different groups may become a way of avoiding clashes and conflict. Currencies will establish communities, bound together by exchanges of information.

We will unbundle different aspects of our lives: thus Starbucks cards might be used as an international currency for luxury food products, or Apple music or Spotify plans/memberships for buying or selling sounds. It is also possible to imagine that the new digital eco-systems may be rebundled in new ways: excessive consumption of coffee or of sugars, for example, might be linked to alerts to medical service providers. And the willingness to use smart currencies might be linked to reduced health and life insurance premia (while correspondingly, an unwillingness would be penalized through higher prices).

New money may be ending the long period of dollar hegemony.

Covid has accelerated that development – as in many other areas of life. It is making for more digital globalization, and less actual globalization, less movement of people and of goods. There is more information flowing – this is the ultimate weightless economy or weightless globalization.

The dollar's centrality was prompted by the global demand for a deep and liquid safe asset; and that centrality will only disappear when alternative safe assets emerge, backed in some cases by non-state providers. In the past, alternative safe assets dominated – when precious metals were the basis for currency issue. Even in the late twentieth century, nostalgic commentators looked back to that era. The alternative is to think of currency as having a real collateral – in this particular case, information generated by the participants in a wide variety of overlapping communities.

The action of 1971 marked the final end of a commodity (gold-based) monetary order, and the beginning a new world of fiat currencies, which the world's governments and central banks only learnt to manage effectively in the 1990s. We are moving to a new monetary order, with a sort of commodity base: information. The learning process of how to manage that new system may be faster than the tumultuous experiments of the late twentieth century: but it won't be easy.

IV. The New Challenge

In these circumstances can a new Bretton Woods be reimagined? There are new problems. Climate change – or more generally perhaps the damage done by the Anthropocene – is a major and increasingly difficult challenge, requiring prompt action. It would also be reasonable to be disappointed by efforts so far, and especially by the recent COP26 in Glasgow. Here an obvious but not sufficiently noted lesson of history may be helpful. Phenomena will remain in the sphere of abstract discussion, nervousness, concern, unless they can be accurately measured. Providing data about costs is essential to

building a consensus about finding solutions. At the time of Bretton Woods, the World Bank, and the IMF, could think differently about development because of a framework of national income accounting that had been developed largely in the industrial countries to meet the challenge of mobilizing resources for war. Today, when newspapers report on the twice yearly Fund meetings, they focus on the assessments of GDP development. They think that GDP matters because the IMF puts that at the center: but when it comes to biosphere, GDP is a cost or a drain rather than an asset: an erosion rather than an enhancement of the wealth of nations.

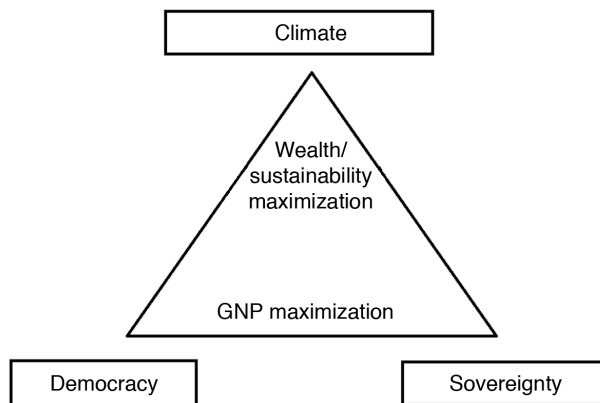
Partha Dasgupta's 2021 review of biodiversity for the UK government has highlighted the need to think differently about growth, and including a measure for the depletion of natural resources in the biosphere, for living on capital. It is the modern equivalent of the wartime work of James Meade and Richard Stone. There is, Dasgupta argues, a need to identify the wedge between "the prices we pay for Nature's goods and services and their social worth in terms of what economists call 'externalities'."³⁰ If such accounting is treated as a simply rhetorical exercise in persuasion, the result will be no action. Prices drive behavior: only when we see the prices can we effectively ensure that the externalities are returned to the inside of the economic system.

Is it possible to describe a new policy trilemma: one in which the trade-offs are between national sovereignty, democracy, and response to the global climate challenge? In the same way as globalization created incentives that seemed to push for a softening of sovereignty and democratic processes, we might think that the costs of climate change will make the same process occur.

The threat of degradation of the biosphere is not the only development that provokes or should provoke concern. A megatrend that will increasingly influence the work of international institutions, including the IMF, is the data revolution, and also the application of

³⁰ *The Economics of Biodiversity: The Dasgupta Review*, U.K. Government, London, February 2021, p. 6.

FIGURE 3
The Environmental Trilemma



new techniques to manage it – including AI. The data provided needs to be much more detailed, and more frequently updated: the ideal is real time data provision, not big jumps every six months with the release of a new WEO and its forecasts. The correct and timely provision of data by member countries has from the beginning been a contentious issue in the Fund: the requirement in the Articles of Agreement to communicate reserve information, including on gold supplies, was probably responsible for one of the fateful early decisions that profoundly affected the role of the IMF in the postwar architecture: the Soviet refusal to participate in December 1945 in the ratification of the Bretton Woods agreements.

Finally, the world security system will shape the economic response: as was the case at Bretton Woods. Today, we are living in a world where security concerns – often loosely described as changing geopolitics – are dominating economic news: whether the debate at the western end of the Eurasian landmass about Russia’s gas provision and gas pricing, or the escalation of tensions around Taiwan and in the South China sea at the eastern side. One of the under-recognized features of the Bretton Woods settlement was the way in

which there was a parallelism between Fund and Bank on the one side and the wider United Nations Organization on the other. The largest five members by quota of the Bretton Woods institutions were identical with the five permanent members of the Security Council: the United States, the Soviet Union, China, the United Kingdom, and France. Stalin's non-ratification of the Bretton Woods agreement meant no Soviet membership; while after the Chinese revolution the Bretton Woods representation remained until 1980 with the Republic (Taiwan).

How can global order be recreated despite apparent anarchy? Interests and ideas had overlapped in creating the postwar monetary order, underpinned by a new approach to accounting and hence for calculating trade-offs. It is striking that in retrospect Bretton Woods appears as the only really successful example of a multilateral redesign of the world's international monetary order: Napoleon III had tried to establish a world money at the World Monetary Conference of 1867; the Genoa conference in 1922 was ineffective in proposing a blueprint for monetary stability after the First World War; in 1971 Richard Nixon termed the Smithsonian meeting the most important monetary conference since the birth of Jesus Christ, but the new exchange rates held for less than two years; and ever since the disintegration of the Bretton Woods regime in the early 1970s economists and policy-makers have been calling in vain for a new Bretton Woods. Such reforms never materialized because of monetary multilateralism: there is no single power or like-minded group of powers that can impose their plan on a complicated and perhaps uncontrollable market of ideas and interests.

Bilateral talks subsequently remained the key to every major success of large-scale financial diplomacy. In the early 1970s, when the fixed exchange-rate regime came to an end, the IMF seemed to have outlived its function. Its Articles of Agreement were renegotiated by the US, which was looking for more flexibility, and France, which wanted something of the solidity and predictability of the old gold standard.

Later in the 1970s, European monetary relations were hopeless

when France, Germany, and Britain tried to talk about them, but were straightened out when only France and Germany took part. In the mid-1980s, when wild exchange-rate swings produced calls for new trade protection measures, the US and Japan found a solution that involved exchange-rate stabilization. Since the 2000s, the major focus of international economic diplomacy is once more bilateral, this time between the US and China. Increased trade tension, militarization, and the discussion of a new Cold War has turned this relationship fraught and unproductive. So – time for a new Bretton Woods?

There is a need for an institutional but also computational or mathematical framework to manage the trade-offs between the demand for general prosperity (sustained incomes) with the preservation of long-term wealth, understood broadly as natural resources. As in previous balances between contending objectives the answers will lie in the middle of the triangle.

In the same way as the Versailles Treaty produced a negative mythology, in which all the bad and unstable elements of interwar politics were attributed to the peace treaty rather than to the destruction of the First World War, or that Richard Nixon stands for the lure of economic and monetary nationalism, Bretton Woods engendered a positive mythology. According to that version, an act of enlightened creative internationalism removed obstacles to aligning the interests of multiple nation states and of economic agents, and providing a new synthesis of state and market. We need comforting myths. Bretton Woods was the intellectual sugar covering that masked the bitter taste of the pill of Realpolitik dollar hegemony – the world that is now fading. Today, as then, a multilateral agreement on global goods is unlikely without a comprehensive and persuasive accounting framework. When that is established, a new Bretton Woods might then generate its own version of a sugar covering for dissent and tension, in a world of multiple currencies but common objectives.