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BRITAIN AND GLOBALISATION SINCE 1850: III. CREATING THE WORLD OF BRETTON WOODS, 1939–1958

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ABSTRACT. During the Second World War, attention turned to reconstructing the world economy by moving away from competitive devaluations, protectionism and economic nationalism that had marred the 1930s. The Americans had considerable economic and political power, and they wished to restore multilateral trade, fixed exchanges and convertibility of currencies. The British government was in a difficult position, for it faced a serious balance of payments deficit and large accumulations of sterling in the Commonwealth and other countries. Multilateralism and convertibility posed serious difficulties. This address considers whether the American government had economic and financial hegemony after the war, or whether it was constrained; and asks how the British government was able to manoeuvre between America, Europe and the sterling area. The result was a new trade-off between international monetary policy, free trade, capital controls and domestic economic policy that was somewhat different from the ambitions of the American government and from British commitments made during and at the end of the war.

In the first age of globalisation of the late nineteenth century, a particular policy trade-off emerged in Britain: fixed exchange rates, free capital movements, free trade and an inactive domestic monetary policy. In the second address, we saw how this trade-off changed from fixed exchanges on the gold standard to competitive devaluations; from capital mobility to controls; from open markets to imperial preference; and from passive to active domestic monetary policies through the pursuit of low interest rates. The result was that Britain experienced more rapid economic recovery than many other advanced industrial economies – but there were also serious shortcomings. Unemployment remained persistently high at a minimum of 10 per cent; total volumes of world trade declined; and nationalistic economic policies throughout the world prepared the ground for warfare. The experience of the 1930s meant that attention during the war soon turned to a new trade-off within the 'inconsistent quartet' that has been discussed in this series of presidential addresses. In this address, I will focus on the outcome at the two major conferences that shaped the post-war world: the Bretton Woods conference of 1944 that created a new international monetary regime; and the Havana conference of 1948 that shaped the trade regime. Together, they set the parameters for British economic policy for the next quarter of a century, until the collapse of the monetary regime in the aftermath of Richard Nixon's decision of 15 August 1971 to suspend the convertibility of the dollar into gold, and the entry of Britain into the European Economic Community in 1973.

The task facing British politicians and officials was a formidable one: the country faced a serious economic and financial crisis, and was apparently at the mercy of a hegemonic United States which was deeply suspicious of British trade policies, urging an end to imperial preference and a swift return to non-discrimination and multilateralism. The Americans were also anxious to return to fixed exchange rates and convertibility of currencies which would be extremely difficult given the weakness of Britain's balance of payments and the scale of Britain's commitments to the sterling area. But was America quite so hegemonic in practice? Could the British government cling to imperial preference and sustain a role for sterling in the face of American pressure? The outcome involved much more than a technical issue of economic policy, for it was also intimately connected with definitions of British identity, whether as part of a dollar-denominated Atlantic world, the sterling area based on the Commonwealth or a European currency zone. The choice also had implications for domestic economic policy, for a swift return to convertibility might entail the creation of a more flexible, market-based economy and a shift away from controls and regulations. These issues were central to British politics in the decade after the war. In this address, I will focus on the outcomes of the debates at the end of the war which created the system that survived until the early 1970s, before turning next time to the dissolution of this particular trade-off and the emergence of another under which we still live – barring any immediate collapse of the world financial system.

In the Anglo-American discussions that provided the basis for the wider agreement reached between forty-four nations represented at Bretton Woods in 1944, priority was given to reestablishing currency stability as a prerequisite for the recovery of trade. In his opening address to the conference, Henry Morgenthau, US secretary of the Treasury from 1934 to 1945, explained the priority of currency disorders to the downfall of the world economy:

> All of us have seen the great economic tragedy of our time. We saw the worldwide depression of the 1930s. We saw currency disorders develop and spread from land to land, destroying the basis for international trade and international investment and even international faith. In their wake, we saw unemployment and wretchedness – idle tools, wasted wealth. We saw their victims fall prey, in places, to demagogues and dictators. We saw bewilderment and bitterness become the breeders of fascism, and, finally, of war.[1]

Why did Morgenthau and the participants at the conference give priority to currency disorders?

Morgenthau believed, and many others agreed, that the depression of the 1930s started from currency disorders and then spread to trade; it was therefore best to fix the monetary problems first in order to create financial stability for the reemergence of multilateral trade. He, and many other leading figures in the American administration, believed that the emphasis of the Department of State under Cordell Hull on reducing trade barriers in the 1930s was inadequate. Hull was a reincarnation of Richard Cobden and his belief that free trade would link together the world in prosperity and peace. The outbreak of war showed that the policy had failed. Morgenthau complained that Hull was 'obsessed by his trade agreements and. . .failed to realize that Japanese militarism and European fascism had released new and ugly forces which. . .could not be controlled politely'. Cobdenism was not enough, for in the words of Harold Ickes, secretary of the Interior, it was 'like hunting an elephant in the jungle with a fly swatter'.[2] Further, monetary policy was technical and could be left in the hands of experts, unlike trade policy which had been a highly controversial electoral issue in Britain since the days of Joseph Chamberlain's campaign for tariff reform. During the Second World War, it continued to divide economists. The economic advisers to the British government were split between believers in the virtues of free trade, such as Lionel Robbins and Roy Harrod, and adherents of protection and imperial preference such as Hubert Henderson – with Keynes steering a pragmatic course between the two.[3] It was better to start with something

[1] *United Nations Monetary and Financial Conference, Proceedings and Documents* (US Department of State, International Organizations and Conference Series, Washington, DC, 1948), I, 81.

[2] J. M. Blum, *From the Morgenthau Diaries: Years of Crisis, 1923–38* (Boston, MA, 1959), 452–3; H. L. Ickes, *The Secret Dairy of Harold L. Ickes*, II: *The Inside Struggle, 1936–39* (New York, 1953), 211, and III: *The Lowering Clouds, 1939–41* (New York, 1954), 218–19.

[3] L. Robbins, *Economic Planning and the International Order* (1937), 232–7; and *idem*, *The Economic Consequences of the War* (1939), 80–5, 88–94, 99; Harrod quoted in R. Skidelsky, *John Maynard Keynes: Fighting for Britain, 1937–46* (2000), 213, 220; H. D. Henderson, 'International Economic History of the Interwar Period', in his *The Interwar Years and Other Papers: A Selection*

that could be dealt with in a reasonably dispassionate manner, and where there was a degree of consensus.[4]

The initial need was to fix monetary disorder, but the experience of fixed exchange rates in the 1920s showed a potential danger: the nationalistic backlash against globalisation arose because domestic prosperity had apparently been sacrificed on the altar of the gold standard. Many economists and politicians on both sides of the Atlantic realised that the only way to contain this threat in future was to ensure that domestic prosperity was not undermined by policies designed for international reasons. In the words of Ragnar Nurske, a leading economist at the League of Nations, 'the problem was to find a system of international currency relations compatible with the requirements of domestic stability'.[5] Hence the first article of the new International Monetary Fund (IMF) that emerged from Bretton Woods was a commitment to 'the promotion and maintenance of employment and real income, and to the development of the productive resources of all members as primary objectives of economic policy'.[6]

Our analysis of the 'trilemma' suggests that the pursuit of domestic prosperity with international currency stability was only possible by sacrificing capital mobility so that interest rates could in future be used to maintain full employment at home without provoking international capital flows and pressure on the exchanges. Keynes saw very clearly that the free movement of capital was incompatible with an active domestic monetary policy: 'The whole management of the domestic economy depends upon being free to have the appropriate rate of interest without reference to the rates prevailing elsewhere in the world. Capital control is a corollary to this.' Hence the Bretton Woods agreement followed the line of Bertil Ohlin, a leading Swedish economist and expert on trade theory: whereas the movement of goods 'is a prerequisite of prosperity and economic growth', the movement of capital was not. The Bretton Woods conference therefore sacrificed capital mobility and article VI section 3 of the articles of agreement of the IMF stated that 'members may exercise such controls as are necessary to regulate international capital movements'. As Keynes said, 'what used to be a heresy is now endorsed as orthodox'.[7]

from the Writings of Herbert Douglas Henderson (Oxford, 1955), 290, 291, 294. On Keynes's changing position, see Skidelsky, *Fighting for Britain*.

[4] G. J. Ikenberry, 'A World Economy Restored: Expert Consensus and the Anglo-American Postwar Settlement', *International Organisation*, 46 (1992), 298–321.

[5] League of Nations [R. Nurske], *International Currency Experience: Lessons from the Interwar Period* (Geneva, 1944), 230.

[6] See J. K. Horsefield, *The International Monetary Fund, 1945–1965*, III: *Documents* (Washington, DC, 1969), 187.

[7] *The Collected Writings of John Maynard Keynes*, XXVI: *Activities, 1943–46: Shaping the Post-War World: Bretton Woods and Reparations*, ed. D. Moggridge (1980), 16–17; E. Helleiner, *States and*

Of course, general agreement on the need to resolve monetary issues did not completely remove dissension between the British and the American architects of the Bretton Woods agreement. Keynes and his American counterpart, Harry Dexter White, the assistant secretary of the Treasury, had two different visions of the post-war order. The story of the negotiations leading up to Bretton Woods is well known and does not require detailed retelling here – a clash between Keynes's clearing union and White's stabilisation fund.[8] Keynes argued that the monetary system should allow adjustments by the creditor nation (the USA) to avoid the problems experienced at the end of the First World War when debtor countries bore the brunt of adjustments through deflation to force down their costs in order to be more competitive. Given the prospect of a huge American trade surplus after the Second World War, the rest of the world would lack dollars which would create a problem for liquidity to fund world trade. Keynes felt that the USA should be obliged to reduce its surplus and that liquidity should be created through an international currency or 'Bancor'.

The Americans were suspicious, fearing that the result would be inflation and manipulation of currencies for selfish ends. The White scheme was more rigid and triumphed at Bretton Woods: it did not create an international currency; adjustments were to be made by the debtors and not by the USA. Competitive devaluations which led to 'beggar my neighbour policies' in the 1930s were banned. The dollar was pegged to gold at $35 per ounce – an arbitrary figure based on nothing more than the level to which Roosevelt allowed the price of gold to rise in the 1930s.[9] Other currencies were then pegged to the dollar within a margin of 1 per cent either way. Modest devaluations were permitted, with the right to make a larger change to the rate if there were a 'fundamental disequilibrium' between exchange rates, with no right to object that domestic policies were the cause of the problem. 'Fundamental disequilibrium' was not defined, and Per Jacobssen, managing director of the IMF, later remarked that he could no more define it than he could

the Emergence of Global Finance from Bretton Woods to the 1990s (Ithaca, 1994), 34, 37; Horsefield, *International Monetary Fund*, III, 194.

[8] For a good account, see Skidelsky, *Fighting for Britain*, Part Two. Details of discussions between Britain and the USA over currency and trade are to be found in *Foreign Relations of the United States, Diplomatic Papers, 1942*, I: *General. The British Commonwealth, the Far East* (Washington, DC, 1960), 163–242; *Foreign Relations of the United States, Diplomatic Papers, 1943*, I: *General* (Washington, DC, 1963), 1054–126; *Foreign Relations of the United States, Diplomatic Papers, 1943*, III: *The British Commonwealth, Eastern Europe, the Far East* (Washington, DC, 1963), 1–110; *Foreign Relations of the United States, Diplomatic Papers, 1944*, I: *GeneraI: Economic and Social Matters* (Washington, DC, 1967), 1–135.

[9] P. Volcker and T. Gyohten, *Changing Fortunes: The World's Money and the Threat to American Leadership* (New York, 1992), 8.

a pretty girl – though 'you can recognize one when you meet one'.[10] In theory, all exchange controls were to be removed after a five-year transition period and full convertibility restored.

The American position largely triumphed in the negotiations leading to Bretton Woods – not surprisingly, given the economic and financial power of the United States. What happened when White's scheme collided with economic reality after the war? Could the Americans utilise their post-war economic hegemony to impose their preferred policies; or was economic hegemony constrained in ways that allowed Britain to secure more than at first sight seemed possible? The modification of White's scheme was crucial to British economic policy and to its identity after the war as an Atlantic, imperial or European nation.

The Bretton Woods agreement was not easily implemented. There were four major issues. The first was a serious shortage of dollars after the war, for the USA would have a massive trade surplus as other countries turned to it for industrial goods during reconstruction. There was a serious problem in securing dollars to pay for imports from America, and a threat to the liquidity of the world economy. How was the dollar deficit to be covered without a serious fall in living standards? Although the European Recovery Program or Marshall Aid covered some of the dollar shortfall, what would happen when it came to an end? Was the deficit transitional, or was it long term and structural? The second issue was how Britain should respond to its balance of payments deficit. The post-war export drive to earn dollars meant that domestic consumption was held down and a policy of austerity adopted. Would the swift restoration of convertibility help by imposing discipline at fixed exchange rates so that an outflow of funds would lead to deflation and cost cutting; or would this approach lead to domestic political difficulties as well as putting pressure on the exchanges? An alternative solution was to reject fixed exchanges and allow the pound to float – a strategy that would entail a rejection of the Bretton Woods scheme. This was closely connected with a third issue: the treatment of the sterling area. Other countries held large balances of sterling accumulated during the war in payment for goods, and convertibility would mean they would switch into dollars to buy American goods. So long as sterling remained inconvertible, these countries were more or less obliged to buy British goods; convertibility would threaten British exports to these 'soft' markets as well as creating a run on the pound. Further, a decision to devalue the pound would have a serious impact on these colonies and countries in the sterling area which would find that their holdings were worth less.

Initially, the American government took a firm line, pressing for a swift return to convertibility. In 1947, the American government made a

[10] *Ibid.*, 20.

loan to Britain conditional on ending the period of transition, insisting that the British government should remove exchange controls and make sterling convertible. This was a triumph of hope over experience. Holders of previously inconvertible sterling rushed to switch into dollars, the loan was rapidly used up, and convertibility was suspended within weeks.[11] The American administration now realised that the European dollar shortage needed to be solved. The problem, it seemed to them, was a lack of production in Europe and the solution was a Customs Union in western Europe to create a large single market with American assistance through the European Recovery Program. Once the European dollar deficit was overcome, it would then be possible to move to an open international economy. The attitude of the British government was different. Although aid was obviously welcome as an alternative to domestic deflation, the dollar shortage was considered to be less the fault of European production than of the USA, and there was considerable scepticism about European integration. After all, Britain had major non-European markets, imperial preference remained a central policy, and the sterling area was central to Labour's economic policy.[12]

Discussion over trade issues started from 1941 in the context of Lend Lease. Article VII of the Lend Lease agreement of 1942 laid down that the final settlement should 'be such as not to burden commerce between the two countries but to promote mutually advantageous economic relations between them and the betterment of world-wide economic relations'. Dean Acheson, who was a member of the American team, felt that the article was too idealistic: 'So far so good; here was a blow struck for the Hull liberal commercial policies open to all. Then came the apple of discord. In addition to promoting good, the final settlement should prohibit evil, or what Mr Hull thought was evil.' The article added that the settlement should 'provide against discrimination in either the United States of America or the United Kingdom against the importation of any product originating in the other country'. In other words, the article was directed against imperial preference which led Keynes to 'burst into a speech such as only he could make', complaining that 'it saddled upon the future an ironclad formula from the Nineteenth Century', and would require an imperial conference to secure the consent of the members of the Commonwealth. Acheson pointed out that the undertaking was not onerous in reality, merely promising that after the war was over, and after receiving considerable aid, Britain would not be free to take measures

[11] See for example A. Cairncross, *Years of Recovery: British Economic Policy, 1945–51* (1985), ch. 6.

[12] See M. J. Hogan, *The Marshall Plan: America, Britain, and the Reconstruction of Western Europe, 1947–1952* (Cambridge, 1987).

against the USA. Article VII provoked six months of discussion before it was agreed on 23 February 1942, and it continued to cause difficulties after the war. As Keynes realised from the outset, the USA would have a massive trade surplus and other countries would have difficulties in paying so that removal of preferences and quantitative restrictions would not be simple.[13]

Of course, Hull was a proponent of the 'ironclad formula' of Richard Cobden. In his memoirs, he remarked that in 1916 he embraced the views he was later to pursue as secretary of state. Until that year, he believed that lower tariffs would reduce prices for American consumers and prevent the growth of trusts and monopolies. After it, he stressed international considerations:

> unhampered trade dovetailed with peace; high tariffs, trade barriers, and unfair competition, with war. . .if we could get a freer flow of trade. . .so that one country would not be deadly jealous of another and the living standards of all countries might rise, thereby eliminating the economic dissatisfaction that breeds war, we might have a reasonable chance of lasting peace.

In 1916, he proposed a post-war international trade conference to remove 'destructive commercial controversies', and in 1917 Woodrow Wilson's Fourteen Points called for the end of international trade barriers.[14] Hull's ambitions were not fulfilled after the First World War; they had more chance of success after the Second World War. Keynes was not impressed by the 'lunatic proposals of Mr Hull', and in his initial plans for post-war institutions he still argued that Britain should retain its protectionist measures, and that anyone who abandoned them 'would be as great a traitor to his country as if he were to sign away the British navy'.[15]

One reason for the success of the conference at Bretton Woods was that Hull was absent and attention could focus on the less contentious currency schemes. However, trade policy did not disappear from consideration and was not left entirely to Hull and his Cobdenite certainties. More realistically, James Meade put forward his plan for a 'commercial union' in 1942. This scheme would complement Keynes's 'clearing union' and it was accepted by the Board of Trade and discussed with the Americans in 1943 and then again in December 1944. Meade started by pointing to Britain's commercial problems at the end of the war, with its high dependence on imports of necessities and its need to increase exports

[13] Skidelsky, *Fighting for Britain*, 126–31, 133; D. Acheson, *Present at the Creation: My Years in the State Department* (1970), 29–30. Details of the discussions over Article VII are in *Foreign Relations of the United States, Diplomatic Papers, 1941*, III: *The British Commonwealth, the Near East and Africa* (Washington, DC, 1959), 1–53; and *Foreign Relations of the United States, Diplomatic Papers, 1942*, I: *General. The British Commonwealth, the Far East* (Washington, DC, 1960), 525–37.

[14] Cordell Hull, *Memoirs of Cordell Hull*, I (1948), 81–2.

[15] Quoted in R. Skidelsky, *John Maynard Keynes: The Economist as Saviour, 1920–1937* (1992), 476–8; and *idem*, Fighting for *Britain*, 179.

of goods which other countries could more easily do without. 'If ever there was a community which had an interest in the general removal of restrictions to international commerce, it is the United Kingdom.' In the past, British trade had been multilateral: British exports went to less-developed areas (above all, India) and the proceeds were used to buy goods from the USA. Multilateral trade was therefore necessary to improve Britain's position, which meant reducing American tariffs from their high pre-war levels and the system of bilateral trade adopted by Germany in the so-called 'Schachtian' policy which was followed by many other countries. He therefore argued for a general policy of financial and economic expansion to increase purchasing power in export markets and 'a removal of those discriminations and rigidly bilateral bargains which remove the opportunities for multilateral trading'. Self-interest as well as the commitments of Article VII meant that Britain was committed to such a policy.

Hull might agree with Meade up to this point, but then they parted company. In Meade's opinion, 'Multilateral trading and the removal of trade restrictions do not. . .imply *laissez-faire*, and are in no way incompatible with a system of state trading.' Further,

> After the war we shall not be in a good position in which we can afford *unconditionally* to abandon all protective devices. We cannot readily indulge in a unilateral policy of removing our protective armour and shall thus desire to retain the right to restrict purchases from, and to discriminate against, those countries which themselves retain highly protective commercial policies or which discriminate against ours. We shall, moreover, need to retain the right to impose more general restrictions on purchases of inessential goods or on unnecessary payments abroad so long as we are faced with an acute problem of restoring equilibrium to our international balance of payments.

Meade argued that the clearing union was essential for the reduction of restrictions on commerce and that solving the currency problem came first: 'it is only in a general milieu of economic expansion that the pressure on the balance of payments of debtor countries is likely to be sufficiently relieved to make possible a really effective lowering of protective devices'. Further, the clearing union would help stimulate the general expansion of demand which was a prior condition for the removal of trade restrictions. Meade proposed an International Commercial Union to reduce trade restrictions: preferences should not be offered to one member without being offered to all; members would reduce protective duties against each other; state trading would be allowed; and an international commission should be established to adjudicate on disputes.[16]

In October 1943, meetings were held with the Americans who were drafting their own report on commercial policy. Meade and Robbins

[16] 'A proposal for an International Commercial Union', in *The Collected Papers of James Meade*, III: *International Economics*, ed. S. Howson (1988), 27–35.

countered American claims that preferences (as adopted in Britain) more than tariffs (used by the Americans) diverted trade from sound economic channels. Somewhat disingenuously, they argued that the USA was a federal union with 100 per cent preference between its members whereas Britain had a Commonwealth with less than 100 per cent preference. 'Why is our arrangement sinful and theirs virtuous?' The claim that the relationship between California and Massachusetts was akin to that between Britain and New Zealand was not likely to convince the Americans, and the British negotiators had to admit that unless action was taken to end their 'peculiarly wicked and dreadful' preferences, there was not likely to be progress on commercial policy.[17]

The American government hoped that solving the currency issue would soon lead to multilateral trade. Keynes differed and commented to Treasury officials in 1944 that

> currency multilateralism is quite distinct from commercial multilateralism and that the former does not imply or require the latter. Indeed, currency multilateralism has been in the past the normal state of affairs without in fact being accompanied by commercial multilateralism. The one no more implies the other in the future than it has done in the past. The fact that those who have a strong sympathy for the one are likely to have a strong sympathy for the other also seems to me to be beside the point. Moreover there is a large and important group. . .who are decidedly in favour of currency multilateralism but very dubious about commercial multilateralism.[18]

Keynes saw potentially serious political difficulties: the commercial proposals were drawn up to satisfy American public opinion which meant they were likely to provoke opposition in Britain where there was already irritation over the terms of Lend Lease. He urged White not to misinterpret any hostile response as a reaction against internationalism – rather, 'this country is immensely exhausted and has made sacrifices so far as encumbering the future goes, far beyond those of the other United Nations'.[19] Keynes hoped for a compromise but he had a very difficult task given the post-war weakness of the British economy which soon became apparent in 1945 during his negotiation of a loan from the Americans.

Hugh Dalton, the chancellor of the Exchequer, was concerned that the Americans might make elimination of imperial preference a condition for financial assistance in 1945 as they had for Lend Lease. He telegraphed

[17] *The Wartime Diaries of Lionel Robbins and James Meade*, ed. S. Howson and D. Moggridge (Basingstoke, 1990), entries for 2 Oct, 1943, 124–5, and 13 Oct. 1943, 136–7

[18] Keynes to D. H. Robertson and W. Eady, 'Monetary and Commercial Bilateralism', 31 May 1944, in *The Collected Writings of John Maynard Keynes*, XXVI: *Activities, 1941–46: Shaping the Post-War World. Bretton Woods and Reparations*, ed. D. E. Moggridge (1980), 25–6.

[19] *Collected Writings of John Maynard Keynes*, XXVI, ed. Moggridge, Keynes to White, 24 May 1944, 27; Keynes to L. Pasvolsky, 24 May 1944, 28–9.