

The Death of Bretton Woods

Bill Ward
(September 2003)

The most lasting development at Bretton Woods (see [The Birth of Bretton Woods](#)) was the transfer of economic leadership from the British Empire to the emergent US empire. The Englishman John Maynard Keynes had come to Bretton Woods intending to retain the place of Britain and the Pound Sterling at the center of the world economy. From his perch as preeminent economist of the day, Lord Keynes looked down his long and imperious nose at Harry White and the upstart Americans and lectured them incessantly throughout the Conference. Meanwhile, Harry White had the power and dominance of the US economy on his side and used that power to dictate the terms of the new system.

At the end of the War, the US Treasury held two-thirds of the world's monetary gold, making the US Dollar the leading candidate for serving as the new international reserve currency. Nominally, Dollars were backed by gold at \$32 per ounce. I say "nominally" because, as the US trade deficit grew in the 1960s, the Bretton Woods system came to depend upon nobody actually asking for gold in exchange for Dollars.

One reason that both Britain and the US wanted the role of central currency is that the issuer of a reserve currency gets to run a trade deficit sufficient to provide the money other countries need for financing their own international trade and for funding their own Central Bank reserves. This confers what is called a 'seignorage' privilege upon the reserve currency country. Bretton Woods allowed the US to be the first spender (for imports) of those Dollars that would go out and monetize the rest of the world. Those particular Dollars would not come back to the US demanding US goods, services, or investments in return.

But by the 1960s, US trade deficits were over-supplying the rest of the world's need for these external Dollars. Fighting the Vietnam War while simultaneously implementing the Great Society programs led to a big US Government Budget deficit.

And the budget deficit caused the trade deficit to expand. As a surfeit of Dollars flowed out of the US, a curious new market of ‘Eurodollars’ emerged from a curious source.

The Soviet Union needed to maintain Dollar balances for its dealings with the rest of the world. To prevent the US government blocking use of those Dollars, the Soviet Union’s Moscow Narodny Bank in London and Banque Commerciale pour L’Europe du Nord in Paris held Dollar balances in London and Paris rather than in New York. This was simply an extension of the long-standing practice of British bankers to hold some foreign currency balances in London as a means of financing international trade flows. As a hedge against inflation and to make a bit of profit, the Soviet banks began lending Dollars out at interest to other users. The practice soon spread. With the burgeoning of the US’s ‘twin deficits’, the Eurodollar market grew from \$1 Billion in 1957 to more than \$100 Billion by 1972.

Complicating things further for the Bretton Woods system was the rising price of gold. By the 1970s, gold had risen to five times—and still rising—greater than the \$32 per ounce at which bullion could be bought from the US Treasury by other Central Banks. The French President Charles DeGaulle, who greatly resented the seignorage privilege enjoyed by the US, began demanding gold for Dollars at the official rate of \$32 per ounce.

With \$100 Billion Dollars in private hands in the Eurodollar market and additional Dollars held at Central Banks around the world, there was no way the US could honor all of the potential demands for gold at the stated price. In August of 1971, President Nixon broke the Dollar’s link with gold and let the Dollar’s value float with respect to that of other currencies. This killed the indirect gold standard spelled out at Bretton Woods. Henceforth, the “faith and credit” of a currency’s issuer would provide its only backing. (See separate article on Currencies, Promises and Contracts.)

With the rise of a Eurodollar market (and later a Eurocurrency market that included such other “hard” currencies as the German Mark) outside the control of any government, the policy autonomy that Keynes had sought became more difficult to maintain. Increasingly, private investors—not just governments—could control international money flows and could clandestinely put that money in the countries where

economic management was best. They could also use their understanding of international economics to stake bets on the direction that currency values would take in those countries where they computed policies and prices to be inconsistent with each other.

While the indirect gold standard died a quick death in 1971, dreams of uncontested national policy autonomy would die more slowly. The first big battles in the policy war were waged during the 1980s, as market liberalization in the US under Reagan and in the UK under Thatcher began to be mimicked by World Bank and IMF rhetoric aimed at the developing countries. By then, the World Bank was lending not just for infrastructure investment but also for structural adjustment—an obvious blurring of the lines of authority separating the Bank from the IMF. By the mid-1980s, just as the Soviet Union was beginning to break up, Continental Europe and a few emerging markets countries like Korea would hear the music of Globalism's growing symphony. Some liked the sound. Others did not. Few, however, could any longer resist its power.