The Bretton Woods institutions

The first steps in building a new economic order were taken at the July 1944 UN Monetary and Financial Conference at Bretton Woods, New Hampshire. At Bretton Woods, the representatives of 44 governments agreed to establish the IMF to help states with short-term **balance-of-payments** problems and the World Bank to provide long-term capital for poor states. The participants of this conference created the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD/World Bank). This arrangement represented a compromise between the ideas of British economist John Maynard Keynes, who led his country's delegation to Bretton Woods, and Harry Dexter White, the chief international economist at the US Treasury. Keynes sought a powerful independent institution to balance American economic power, whereas White sought an organization that would be an adjunct to US economic power. The plans for the system of Bretton Woods were developed by two important economists of these days, the American minister of state in the U.S. treasury, **Harry Dexter White**, and the British economist **John Maynard Keynes** who stated: " We, the delegates of this Conference, Mr President, have been trying to accomplish something very difficult to accomplish.[...] It has been our task to find a common measure, a common standard, a common rule acceptable to each and not irksome to any." This statement outlines the difficulty of creating a system that every nation could accept.

The ideas of John Maynard Keynes and Harry Dexter White have been described as very different from each other on several occasions but in fact there are extraordinary similarities. According to the **White** plan, a Bank for Reconstruction (today the World Bank) and an International Stabilization Fund should be established. The **Keynes** plan called for the same. The only difference was that Keynes wanted to vest the IMF with possibilities to create money (a fact that can easily be understood in the background of Great Britain's suffering from the deflation policies in the Inter-War period) and with the authority to take actions on a much larger scale. In case of balance of payments imbalances John Maynard Keynes recommended that both sides, debtors and creditors, should change their policies. Countries with payment surpluses should increase their imports from the deficit countries and thereby create a foreign trade equilibrium. Harry Dexter White, on the other hand, saw an imbalance as a problem only of the deficit country. Economists today agree that White was mistaken and Keynes was more farsighted. However, Keynes' plan was never discussed seriously at Bretton Woods and the participants agreed on the White plan.

The conference also encouraged tariff reduction to stimulate world trade, and the 1947 Havana Conference adopted the General Agreement on Tariffs and Trade (GATT) as the charter for a proposed International Trade Organization (ITO). Fearing that the ITO would undermine US sovereignty, however, Congress refused to approve its establishment. The GATT remained as an international forum to promote tariff reduction and resolve trade disputes. Its key norm was the **most-favored-nation (MFN) rule** that requires countries to treat one another equally in trade relations by according the same (lowest) tariff rates on imports from *all* countries. If one country reduces tariffs on imports of another country, it has to extend the same reductions to other countries. The IMF, World Bank, and the GATT became pillars of the global economic system, and, as that system evolved, so did their role. Today, they reflect the interdependence of actors in a globalizing world, reinforce neoliberal norms, and provide global economic governance.

The United States defined the value of its dollar in terms of gold, so that one ounce of gold was equal to $ 35. All other members had to define the value of their money according to what was called the "par value system" in terms of U.S. dollars or gold.

For nearly two decades, the Bretton Woods system was effective in controlling conflict and achieving the common goals of its members. The rules, institutions, and procedures of the system were embodied in three organizations created during and immediately after World War II. Named for the New Hampshire town in which two of the organizations—the International Monetary Fund (IMF) and the World Bank—were created, the Bretton Woods system consisted of those two organizations plus the General Agreement on Tariffs and Trade (GATT). These three institutions have evolved significantly over time but remain cornerstones of international economic governance to the current day. During the Bretton Woods era, international economic interaction was still limited but growing. In the early years of Bretton Woods, many countries were recovering from the devastation of the war and were in no position to compete internationally. Tariffs, quotas, and exchange controls protected national markets and hampered the international flow of goods and money. International investment was limited and concentrated heavily in raw materials and retailing, not in manufacturing.

The Bretton Woods system rested on three political foundations: the concentration of power in a small number of states, the existence of a cluster of important interests shared by those states, and the presence of a dominant power willing and able to assume a leadership role. The concentration of both political and economic power in the developed countries of North America and Western Europe enabled these countries to dominate the Bretton Woods system. They faced no challenge from the communist states of Eastern Europe and Asia (including the Soviet Union), which were isolated from the rest of the international economy in a separate international economic system. Although the less-developed countries (LDCs) were integrated into the world economy, they had no voice in management because of their political and economic weakness. For much of this period, many developing countries in Africa and Asia were still subordinated within colonial empires. Finally, Japan, weakened by the war and lacking the level of development and the political power of North America and Western Europe, remained outside the management group for much of the Bretton Woods era. As a defeated power, Japan was not initially a member of the Bretton Woods institutions. It joined the IMF and World Bank in 1952 and did not become a member of the GATT until 1954. The concentration of power facilitated the system's management by confining the number of actors whose agreement was necessary to establish new international economic regimes and to carry out management within the agreed upon system

The International Monetary Fund (IMF)

The IMF was designed to promote economic stability by regulating monetary policy and currency exchange rates–the price of a country's currency in terms of other countries' currencies. It is an intergovernmental organization managed by a board of governors. Day-to-day work is handled by a managing director – customarily nominated by the European Union, an arrangement that is balanced by America's leading role in selecting the World Bank president. Stable exchange rates are vital because trade and investment require payment. Countries have different currencies, and the currency of one country cannot be used to buy goods from another. Thus, importers need to convert money into the currency of the countries from which they are purchasing goods. *Currency is a commodity like wheat or iron, and its value varies depending on supply and demand*. If more people want dollars because they believe the dollar's value will rise, the demand for dollars will increase, and the dollar's value relative to other currencies like the euro or yen goes up. The result is a "strong dollar." But, if the demand for dollars declines, the dollar's relative value also declines, resulting in a "weak dollar." When a country's currency is strong, it can purchase imported goods inexpensively, and imports rise. Since a country's products are priced in its currency, a strong currency also means that its exports are expensive for foreigners to buy, and exports decline. Thus, countries that want to increase exports may devalue their currency relative to other currencies. For much of the nineteenth and early twentieth centuries, countries adhered to the gold standard, by which the value of all currencies were linked to fixed quantities of gold into which they could be converted. Since currency exchange rates were fixed, exchange rates were stable, thereby facilitating the settlement of trade transactions. After 1933, America abandoned the gold standard in favor of a modified system in which gold coins were no longer used but gold still defined the value of the dollar at a fixed rate of $35 an ounce.

The IMF's main task was to restore a monetary system based on convertible currencies and **fixed exchange rates** and prevent competitive devaluations. Fixed exchange rates, however, make the system rigid. With fixed exchange rates in which the value of other currencies was pegged to the US dollar, it was not possible for a country to devalue its currency to increase exports. The IMF was responsible for maintaining stable exchange rates by providing short-term loans to help states manage temporary balance-of-payments deficits. The IMF's task grew more complicated and its role expanded with the collapse of part of the Bretton Woods system in the early 1970s. To combat domestic inflation and a spiraling balance-of-payments deficit during the Vietnam War, the Nixon administration decided that the US could no longer afford to subsidize global trade by maintaining a strong dollar. On August 15, 1971, the US announced it would no longer maintain a system of fixed exchange rates and that dollars could no longer be converted to gold.

Several reasons accounted for this decision. First, as monetary interdependence deepened, it became difficult to coordinate so many states' policies. Transnational banks and corporations had learned how to take advantage of slight fluctuations in interest and currency rates, for example, by buying "cheap" gold and selling dollars in the belief that the US dollar was overvalued, and these practices were beyond IMF control. Second, Europe and Japan had recovered from wartime destruction and wished to reduce their political dependence on America. Washington had previously accepted a trade deficit and an outflow of dollars to help allies recover by providing them with funds to purchase needed imports. By 1971, this was no longer necessary. Third, US spending to wage war in Vietnam and combat poverty at home had stimulated global inflation. US inflation meant that dollars were worth less, but, since adjustment was impossible with fixed exchange rates, that inflation was exported to US allies. Fourth, the Nixon administration wanted to stem the decline in the US trading position but could not do so as long as fixed exchange rates prevented the dollar's devaluation.

America's action heralded an era in which currencies were permitted to "float" in relation to one another, their value determined by supply and demand. With some exceptions, **floating exchange rates** remain the norm. If exchange rates float freely, the currencies of strong economies will rise, while those of weak economies will fall. If a country refuses to let the value of its currency rise freely, however, it will artificially increase its exports and reduce imports, a practice that the US claimed China was following until recently. Currency speculation is inevitable with huge amounts of money racing around the world every day, and maintaining monetary stability – vital for world trade – is a persistent challenge.

IMF funds that are loaned to countries to bolster their currencies are provided by member states, each with a quota based on its economy's size that is reviewed every five years. The IMF also has a large gold reserve that it can sell for additional funds. As of February 2013, the IMF had available $769.2 billion. A country's quota determines its voting power in the organization. Thus, the world's richest countries dominate the IMF. The US has 16.59 percent of the votes in the IMF in contrast to tiny Nauru with 0.03 percent. The IMF's 11 richest members, mostly from North America and Western Europe plus China, Japan, Brazil, and Russia, dominate the organization with 55.07 percent of the votes. A member's quota also determines how much it may borrow from the IMF in a financial crisis.

As guardian of the world's monetary system, the IMF monitors economic trends and consults annually with members – "surveillance discussions" – about their monetary policies. The IMF also establishes standards for financial practices to help countries avoid economic crises. Such crises occur owing to large and persistent budget deficits, high external debt burdens, weak or corrupt banking systems, overvalued currency, natural disasters, and domestic violence and wars. Such factors reduce exports, thereby creating balance-of-payments deficits, loss of investor confidence, and panic selling of foreign-owned assets in the country ("capital flight"). Speculators can undermine a country's economy overnight by massive sales of its currency, causing its value to collapse.

In a crisis, the value of a country's currency drops precipitously, and the country loses **hard currency**, as speculators sell local currency for US dollars, European euros, Japanese yen, or gold. The outflow of hard currency and gold make it impossible for the country to pay its debts, most of which require repayment in hard currency, or to import essentials because sellers refuse payment in local currency. As local currency depreciates, citizens' savings and pensions are wiped out. Economic activity comes to a standstill, causing massive unemployment and widespread hardship.

The IMF can play a key role in such crises by lending a beleaguered country hard currency to reassure investors. IMF aid, however, has strings attached to it that entail a loss of a country's control over its economy. Loan recipients must agree to "conditions" that are stated in a Structural Adjustment Program that outlines the economic policies the country must follow to receive loans. The IMF is widely viewed as a surrogate for rich capitalist countries that dominate it and an advocate of those countries' free-market ideology. Adjustment programs reflect the IMF belief in economic liberalism and privatization. They often require currency devaluation to enhance exports and reduce imports, the balancing of government budgets (by raising taxes and reducing expenditures), lifting government restrictions on imports, exports, and private investment, and ending state subsidies.

These policies reflect the "Washington Consensus," a term coined by John Williamson, who declares, "the world over seem to believe that this signifies a set of neoliberal policies that have been imposed on hapless countries by the Washington-based international financial institutions and have led them to crisis and misery." Economist Joseph Stiglitz criticizes such IMF requirements as "based on the outworn presumption that markets, by themselves, lead to efficient outcomes, failed to allow for desirable government interventions in the market, measures that can guide economic growth and make *everyone* better off."

Once the IMF approves a country's reform program, other countries and foreign banks are likely to reinvest in the country and agree to reschedule its foreign debt – key steps in restoring economic health. Most IMF assistance is made through agreements called Stand-By Arrangements in which loans are extended at market-based interest rates. However, poor countries can obtain lowinterest **concessional loans**. Total IMF loans peaked at $95.8 billion in 2012 owing to the Great Recession and declined to $54.4 billion in mid-2016 following the recession.29 The IMF also assumed the role of providing the newly energized G-20 with staff support and evaluating how a global tax on financial institutions might be levied.

In 2010, the IMF joined the European Union in providing Greece with $60 billion in loans. Greece confronted the prospect of defaulting on the debts it had amassed in previous years by borrowing to finance annual budget deficits. By that time debt rating agencies such as Standard and Poor's and Fitch had downgraded Greek government bonds to virtual junk status, and there was a growing risk that a Greek default would cripple, not only Greek banks, but foreign banks, especially in Germany and France, that had made earlier loans to Athens. An additional risk was that investors' panic over Greece would spread to other indebted European countries. Facing an economic and financial maelstrom that threatened to spread across Europe and cross the Atlantic, the IMF agreed to provide up to $317 billion to supplement an EU stabilization fund that would be available to rescue other eurozone members with serious debt problems. Thereafter, Ireland and Portugal also requested assistance and like Greece agreed to institute austerity programs. To provide amounts that, as in the Greek case, exceed such countries' IMF quota, the IMF itself borrowed from other countries, notably, China, Brazil, Russia, and India.

Although the IMF had lessened the severity of the conditions it sets to make loans after its experience during the "Asian contagion" of the late 1990s (see pp. 407–8), conditionality – the conditions it attaches to loans – was much in evidence during the European crisis. To obtain the EU/IMF loans, the Greek government had to pledge dramatic cuts in spending and increases in taxes to reduce its budget deficit from 13.6 percent of gross domestic product to below 3 percent by 2014. In order to cut its budget by $37 billion within three years, Greece agreed to do away with bonus payments and freeze salaries and pensions for government workers for three years, increase sales tax from 19 to 23 percent, raise taxes on fuel, alcohol and tobacco by 10 percent, and raise the average retirement age from 61.4 to 63.5. Greece also pledged to reduce tax evasion and eliminate corruption among tax and customs officials.30 Owing to its efforts to comply with IMF conditions and concern that Greece might leave the eurozone, the IMF approved additional large-scale loans to Greece in 2012 but recommended that the country be allowed to institute policies designed to encourage growth rather than austerity.

Austerity policies imposed as EU/IMF conditions produced resentment. Lower government spending and higher taxes meant an economic slowdown, accompanied by higher prices and spreading unemployment. Greek workers were furious at ending a system that had guaranteed them lifetime employment and early retirement. National boundaries afforded no protection against economic storms, and globalization had eroded the capacity of Athens to manage domestic economic policy. Angry Greeks, especially public service workers, reacted to these conditions by taking to the streets (see Figure 12.2). Their anger led to the electoral triumph of the left-wing Syriza political party in early 2015 led by Alexis Tsipras who became prime minister on an anti-austerity program. However, despite a referendum that approved his opposition to EU/IMF conditions for a bailout, Tsipras, ultimately capitulated in July to the EU/IMF requirements.

As the Greek case indicates, IMF reform programs may increase poverty and political unrest in countries receiving aid. Declines in government spending increase unemployment, and ending subsidies for staples like bread, rising costs for basic goods, and reduced public services may trigger a popular backlash against a government and the IMF, strain social and political institutions, and threaten political stability. The IMF and lending banks advocate government non-intervention in the economy and reliance on the global market. They regard market stability as more important than a state's economic autonomy. Countries in crisis have little choice but to accept IMF conditionality because private banks will no longer extend loans and, without IMF aid, default is the only (unpalatable) alternative. We now turn to the second institution conceived at Bretton Woods, the World Bank. The World Bank, which actually consists of several agencies, is a major source of development assistance for poor countries and increasingly has become an advocate of sustainable development.

The World Bank

The World Bank was originally established to fund post-World War Two reconstruction but soon turned to the task of economic development. Like the IMF, the World Bank is an intergovernmental grouping with a board of governors and executive board. The bank's president is by custom an American and is currently *Jim Yong Kim, a Korean-American public health expert who succeeded former Trade Representative and Deputy Secretary of State Undersecretary of State Robert* Zoellick. Funded by members' contributions and borrowing on global capital markets, the bank makes lending decisions on market principles – loan rates and prospects for repayment.

For years, the bank funded large, splashy infrastructure projects such as dams that critics argued provided little help to the poor and ignored environmental consequences. In recent years, however, the bank has focused more on the problems of the poorest countries, has raised additional funds for this effort, and provides borrowers with low interest loans to alleviate poverty and stimulate sustainable economic growth.

In 2014, China established the Asian Infrastructure Development Bank as an alternative to the World Bank with initial projects in Bangladesh, Indonesia, Pakistan, and Tajikistan. "China will use the new bank to expand its influence at the expense of America and Japan, Asia's established powers." China's initiative as well as its role in joining other BRICS to fund the New Development Bank reflects its frustration with what the group regard as an insufficient governance role in existing global economic institutions. The GATT and its successor, the World Trade Organization (WTO), is the third institutional pillar of the economic system. Like the IMF and World Bank, the WTO is responsible for a specific aspect of global economics, in this case world trade. In this role, it, too, promotes a neoliberal economic agenda, and it is a leading institutional exponent of globalization.

Goals

The World Bank is the world's most important source of financial aid for developing nations. It provides "nearly $16 billion in loans annually to its client countries. It uses its financial resources, highly trained staff, and extensive knowledge base to help each developing country onto a path of stable, sustainable, and equitable growth in the fight against poverty." Its goals are to improve living standards and to eliminate the worst forms of poverty. It supports the restructuring process of economies and provides capital for productive investments. Furthermore, it encourages foreign direct investment by making guarantees or accepting partnerships with investors. The World Bank aims to keep payments in developing countries balanced and fosters international trade. It is active in more than 100 developing economies. It forms assistance strategies by cooperating with government agencies, nongovernmental institutions and private enterprises. It offers financial services, analytical, advisory, and capacity building.

Organisation

The World Bank is an independent organisation of the United Nations. Each country that wants to join it, has to be a member of the IMF. The highest authority of the World Bank is the Council of Governors, which consists of one representative of each country. The Executive Board consists of five Directors to whom the Council of Governors transfers responsibility for nearly all issues. The President of the World Bank is de facto elected by the U.S. government and then confirmed by the Executive Board. He is involved in the current activities.