Bretton Woods, the name of the remote New Hampshire town where representatives of 44 Allied nations met in July 1944, three weeks after the D-Day landings at Normandy, has become virtually synonymous with enlightened, cooperative globalisation. After all, the legendary quarter-century “Bretton Woods era” was one marked by robust economic recovery from the second world war and the formalisation of a multilateral trading system. It was, therefore, no surprise that, in the wake of the global financial crisis, world leaders from the then French president, Nicolas Sarkozy, to Gordon Brown, the British prime minister at the time, were calling for “a new Bretton Woods” to restore economic order and defuse trade conflict.

Yet, contrary to legend, Bretton Woods, which established new institutions and rules for global monetary and financial cooperation, actually played little role in the post-war economic revival. The International Monetary Fund it created, which was supposed to help restore global trade by providing loan financing for countries in balance of payments difficulties, was mothballed by the Truman administration in the war’s immediate aftermath and remained moribund for much of the subsequent decade.

In mid-1949, the IMF directors confessed that after four years of peace “dependence on bilateral trade and inconvertible currencies is far greater than before the war”. In 1952, they lamented that there had been “little secure or sustained progress toward the Fund objectives of unimpeached multilateral trade and the general convertibility of currencies”. Europe’s revival in the 1950s was driven not by the IMF, or the World Bank, but rather massive grants-in-aid from the 1948 Marshall Plan – a conscious repudiation of the Bretton Woods playbook, which relied on a strategy of piling more debt on countries in balance of payments difficulties, was mothballed by the Truman administration in the war’s immediate aftermath and remained moribund for much of the subsequent decade.

As the US solved one global problem, it began creating another – those surpluses began falling away in short order. Excepting a brief period around the 1956 Suez crisis, the US current account with western Europe was on a pronounced downward trend throughout most of the 1950s, falling into a large deficit at the end of the decade. US exports of capital and economic aid were sustained throughout most of the decade at levels well in excess of the surpluses the country ran with the world as a whole, the gap showing up in two important places: rapidly rising foreign holdings of dollars and huge US gold losses as foreigners repatriated capital to take advantage of higher European interest rates. So, as the US solved one global problem, a global scarcity of dollars, it began creating another one – a scarcity of gold with which to pay back foreign holders of excess dollars.

Harry Dexter White, the IMF’s American architect, simply stated, had been wrong. Contrary to his firm belief, the US could not simultaneously keep the world adequately supplied with dollars and sustain the large gold reserves required by its gold-convertibility commitment. In fact, no country could perform such a feat with its national currency. The logic was laid bare by Belgian-born American economist Robert Triffin in his now-famous 1959 congressional testimony. There were, he explained, “absurdities associated with the use of national currencies as international reserves”. It constituted a “built-in destabiliser” in the world monetary system. The December 1958 European convertibility pledges, far from representing the final critical step into a new monetary era, “merely return[ed] the world to the unorganised and nationalistic gold exchange standard of the late 1920s”.

When the world accumulates dollars as reserves, rather than gold, it puts the US in an impossible position. Foreigners lend the excess dollars back to the US. This increases US short-term liabilities, which implies that the US should boost its gold reserves to maintain its convertibility pledge. But there’s the rub: if it does so, the global dollar “shortage” persists; if it does not, the US ultimately winds up hopelessly trying to guarantee more and more dollars with less and less gold. There is no stable, durable circumstance in which the US can emit enough dollars to satisfy the world’s trading needs and few enough to ensure that they can always be redeemed for a fixed amount of gold. The US is ultimately damned if it meets the world’s liquidity requirements and damned if it doesn’t – as is the rest of the world. This became known as “the Triffin dilemma”.

If concerted international action were not taken to change the system, Triffin explained, a deadly dynamic would set in. The US would need to deflate, devalue or impose trade and exchange restrictions to prevent the loss of all its gold reserves. This could cause a global financial panic and trigger protectionist measures around the world. White’s creation, in Triffin’s rendering, was an economic apocalypse in the making.

What could prevent this? Harold Macmillan, the British prime minister, told President John F. Kennedy in 1962 that “if the gold price were [doubled] to $70 an ounce, most of the difficulties would be over and done with”. Although not a solution to Triffin’s dilemma, this might well have bought time for an orderly transition out of White’s system. But like Churchill in the early 1920s, Kennedy would not countenance devaluation; he viewed it as a crisis-state. Austerity, likewise, was not on the cards. Instead, the US resorted to
plugging the dykes with taxes, regulations, gold market interventions, central bank swap arrangements and moral suasion directed at banks and foreign governments – just as Triffin had anticipated.

Not every government was wholly cooperative. Charles de Gaulle, the French president, blasted the “monumentally over-privileged position that the world had conceded to the American currency since the two world wars had left it standing alone amid the ruins of the others”. The world, he said, had been given “no choice but to accept the international monetary system known as the ‘gold-exchange standard’, according to which the dollar was automatically regarded as the equivalent of gold”. The US “reluctance to forgo its hegemony had led it continually...to issue dollars, which it used for lending to other countries, for paying its debts, or for buying goods, well in excess of the true value of its reserves”.

Moreover, the US used its dominant position at the IMF to keep its trading partners from exercising their right to redeem excess dollars for gold. In September 1963, De Gaulle ordered the Bank of France “to demand from the Americans that 80 per cent of what they owed us by virtue of the balance of payments should henceforth be repaid in gold”.

The French president gave a famous press conference on 4 February, 1965, in which he elaborated the economic logic behind his conclusion that the dollar could never act as “an impartial and international trade medium...it is in fact a credit instrument reserved for one state only”. He was no economist, so it was apparent that the acuity of his analysis was owed to someone schooled in the art.

Although he denied being “in any degree scriptwriter to General de Gaulle”, this was unmistakably John Maynard Keynes’s old intellectual sparring partner over German first world war reparations, Jacques Rueff. The French economist became, with Triffin, the most notable prophet of doom during the 1960s – preaching the inevitable implosion of the dollar-based Bretton Woods system. Although the diagnoses of the two were identical, the proposed cures could not have been more different.

Triffin hearkened directly back to Keynes’s “bancor” alternative to the White plan: a new international reserve currency managed by the IMF. He suggested some bureaucratic safeguards against the potential inflationary bias of the scheme, but was otherwise satisfied simply to quote Keynes at length. Rueff, in stark contrast, advocated a return to the pre-1914 classical gold standard. He was adamantly that he had “no religious belief in gold”; other commodities might in principle do as well, even if gold had history on its side. It was rather the mechanism of a genuine gold standard that was needed to ensure that global imbalances were automatically restrained by credit expansion in the surplus country and contraction in the deficit country – or put alternatively, “to prevent the home population from consuming a part of domestic production that must be made available for export” in order to counteract a payments deficit.

Triffin’s (and Keynes’s) alternative of a new international reserve unit, in Rueff’s view, represented a “purely arbitrary creation of means of foreign payment”; or put more bluntly, “nothingness dressed up as currency”. It had a built-in inflationary dynamic that no bureaucracy would be able to control. For his part, Triffin believed that Rueff’s vision “implied the total surrender of national sovereignty...over all forms of trade and payment restrictions, and even over exchange rates”. Such surrenders, he said, were “utterly inconceivable today in favour of a mere nineteenth century laissez faire, unconcerned with national levels of employment and economic activity”.

The political stage was now set for a reform to Bretton Woods that could mean all things to all governments, but nothing to the markets. This was the IMF’s Special Drawing Right, or SDR, approved by the Fund’s board of governors in 1968. For supporters of Keynes’s bancor vision, the SDR was a first small step on the road to a truly international fiat currency. For France and opponents of the dollar-based Bretton Woods system, the new gold-linked instrument was a step towards dethroning the dollar and restoring gold as the primary international reserve. And for the US, it was a means of buying time to halt the drain on American gold reserves – an expedient to supplement the new policy of limiting gold transactions to monetary authorities, which could ostensibly be bullied into not converting dollars for gold.

By the time SDRs were activated the following year, the world was already well on its way to resolving one of the main problems that motivated their creation: a supposed shortage of international liquidity: in actuality, a shortage of US dollars. Inflation climbed rapidly under the Nixon administration, reaching nearly 6 per cent in 1970, and world dollar reserves rose sharply. Few were any longer clamouring for SDR dollar surrogates – there was more than enough of the real stuff to go around. The problem was now whether an ever-more abundant dollar could remain credibly moored to a fixed quantity of gold. As Valéry Giscard d’Estaing, French finance minister, would put it in 1970, the US “could not eternally ask people to set their watches by a defective clock”. The Nixon administration had either to subordinate its domestic economic agenda, and its pricey military prerogatives in places such as Vietnam, to the needs of the Bretton Woods system, or to abandon the pretense that the dollar had an ordained privileged place in this architecture.

Fed officials warned that a dollar confidence crisis could break out at any time. But as Paul Volcker, then under-secretary for monetary affairs at the Treasury, later reflected: “Presidents – certainly Johnson and Nixon – did not want to hear that their options were limited by the weakness of the dollar.” Nixon certainly had no attachment to the arcane monetary contraptions fashioned by White, whom he had long been convinced was, in the 1930s and 1940s, a Soviet spy. (Spoiler alert: he was.)

By May 1971, pressure on the dollar had become too much for Germany to bear. The deutsche mark, revalued in 1961 and 1969, had been driven further upwards by relentless capital inflows – $9.6bn ($56bn in today’s dollars) since 1970. After a bruising internal debate, the German government floated the mark on 10 May. While this succeeded in curbing speculative flows into Germany, it did not halt flows out of the US.

Nixon’s Treasury secretary, John Connally, a self-proclaimed “bullyboy,” angrily rejected suggestions from the IMF managing director, Pierre-Paul Schweitzer, that the US raise interest rates or devalue the dollar, instead blaming Japan, the newest destination for

De Gaulle called for the US to repay in gold 80% of what it owed France
speculative capital in the wake of the mark’s float, for its “controlled economy”. Connally wanted the yen revalued. He argued publicly for greater access to foreign markets for US goods, and privately that the US “would have to revise its mutual security arrangements especially regarding Japan and Germany” to address its payments imbalance. Japan would not budge.

On 6 August, a congressional subcommittee issued a report entitled Action Now to Strengthen the US Dollar, which, paradoxically, concluded that the dollar needed to be weakened. Dollar dumping accelerated. France sent a battleship to take home French gold from the New York Fed’s vaults. Debate in Washington over how to respond was heated. Nixon opted for what Connally convinced him would be seen as a bold and decisive move. On 15 August, the president went on national television to announce his New Economic Policy.

In addition to tax cuts, a 90-day wage and price freeze and a 10 per cent import surcharge, the gold window would be closed – the US would no longer redeem foreign government dollar holdings.

Schweitzer had been given a mere hour’s advance warning – a clear breach of American IMF obligations. Connally followed this by making the president’s priorities brutally clear to a group of European officials, telling them that the dollar was “our currency, but your problem”.

The Bretton Woods monetary system was finished. Although the bond between money and gold had been fraying for nearly 60 years, it had throughout most of the world and two-and-a-half millennia of history been one that had only been severed as a temporary expedient in times of crisis. This time was different. The dollar was in essence the last ship moored to gold, with all the rest of world’s currencies on board, and the US was cutting the anchor and sailing off for good. This should, White had believed, have meant the end of the dollar’s international hegemony.

“There are some who believe that a universally accepted currency not redeemable in gold...is compatible with the existence of national sovereignties,” he wrote in 1942. “A little thought should, however, reveal the impracticability of any such notion. For any foreign country is willing to accept dollars in payment of goods or services today because it is certain that it could convert those dollars in terms of gold at a fixed price.”

The world would face rough waters before it would find out whether it was right. Would it lapse into a 1930s-style spiral of protectionism? Or could an international monetary system of sorts be made to work without gold?

Schweitzer angered the Nixon administration by taking to the airwaves himself to argue that the system could be sustained through a general adjustment of the fixed exchange rates. “You might call it a devaluation of the dollar. You might call it a realignment of other currencies,” he said. Following a difficult two days of bargaining among the G10 countries at Washington’s Smithsonian Institution in December, Schweitzer got his wish. On average, the dollar was devalued by about 10 per cent, with the deutsche mark appreciating 13.57 per cent, the yen 16.9 per cent and gold 8.57 per cent (to $38 an ounce). Permissible currency movements around the new parities were expanded from 1 per cent to 2.25 per cent. Nixon hailed the accord as “the most significant monetary agreement in the history of the world”.

The disappointing history of monetary agreements notwithstanding, this was nonsense. Nixon faced an election the following November, and was not about to tie his fortunes to the mast of new dollar parities. Appointed Treasury secretary in June 1972, George Shultz, an opponent of fixed exchange rates, continued his predecessor’s blunt disownment of American obligations to the system: “Santa Claus is dead,” he pronounced.

The president successfully bludgeoned Arthur Burns, the Fed chairman, into cutting interest rates, which fuelled monetary growth around the world. In January 1973, two months after his thumping defeat of Democratic challenger George McGovern, Nixon ended wage and price controls – dollar outflows resumed. Volcker secretly flew to Tokyo and Bonn to negotiate new parities, but Shultz opposed the administration undertaking any obligation to defend them, which would have interfered with his priority of eliminating capital controls.

In tense multilateral discussions, the US now took up the battle stance that Keynes and the British had adopted, and White resolutely opposed, at Bretton Woods: surplus countries should be forced to reduce their surplus positions. Congressmen even demanded that the formerly hated scarce-currency clause be invoked against countries such as Germany and Japan. Whether surplus countries were prudent and responsible, or obstinate and selfish, it seemed, depended on whether one’s country was among them. Such a stance did not bode well for any sort of durable international monetary cooperation.

In March 1973, the G10 formally acknowledged the end of nearly two years of tortuous efforts to re-establish a world of fixed exchange parities. No IMF member was any longer in conformity with the Articles of Agreement. The US refused to support Schweitzer for another term, and pushed him out in September, despite vigorous European objection, which, in the case of France, appeared to be more about the bullying American stance rather than the substance of Schweitzer himself.

The new managing director, the former Dutch finance minister, Johannes Witteveen, initiated the IMF’s historic break from its founding principle of fixed (but adjustable) exchange rates. “In the present situation,” Witteveen said in January 1974, “a large measure of floating is unavoidable and indeed desirable.”

Germany and France, however, never abandoned their determination to fix rates at the European level – the creation of the euro in 1999 marking the culmination of decades of painstaking political effort to make such a system indelible, and moreover, to establish a firmer foundation for deeper European political integration.

By 2011, however, the continental debt crisis had shown that monetary union did not itself substitute for a viable political mechanism to orchestrate the mutual accommodation of surplus and deficit countries; indeed, it made such a mechanism a necessary condition for maintaining the union.

Benn Steil is director of international economics at the Council on Foreign Relations. He is the author, most recently, of The Battle of Bretton Woods: John Maynard Keynes, Harry Dexter White and the Making of a New World Order