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THE PAST, PRESENT AND FUTURE OF THE INTERNATIONAL MONETARY SYSTEM: A REVIEW ESSAY

by

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A Search for Solvency: Bretton Woods and the International Monetary System, 1941-1971. By Alfred E. Eckes, Jr. Austin: University of Texas Press, 1975. Pp. xiii, 355. $10.00. The Dilemmas of the Dollar: The Economics and Politics of United States International Monetary Policy. By C. Fred Bergsten. New York: New York University Press for The Council on Foreign Relations, 1975. Pp. xv, 584. $28.50. Money and the Coming World Order. Edited by David P. Calleo. New York: New York University Press for The Lehrman Institute, 1976. Pp. xv, 120. $7.95 cloth, $3.95 paper.

Each of these books purports to take as its subject the past, present and future of the international monetary system and, to a lesser extent, the international economy. In fact, the primary historical emphasis of each book is different: over sixty per cent of the text of A Search for Solvency concentrates explicitly on the 1941-1945 period, while twenty-five per cent of the text is a survey of the 1946-1971 period; The Dilemmas of the Dollar concentrates on the 1959-1971 period; and the four essays in Money and the Coming World Order focus on the future. Direct comparisons among these books are, therefore, not particularly relevant, and considerations of convenience suggest that they should be examined in chronological order.

The major contribution of A Search for Solvency is its thorough and absorbing description of the diplomatic and political events before, during and after the Bretton Woods Conference in July, 1944. Eckes treats not only the conference itself, which is fascinating reading, but also the origins within the U.S. Government of the U.S. plans for the International Monetary Fund (I.M.F.) and the International Bank for Reconstruction and

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Development (I.B.R.D. or World Bank), negotiations with the British and, to a lesser extent, other governments prior to Bretton Woods, and the successful efforts to obtain Congressional approval of the Bretton Woods Agreements Act.

The strength of Eckes' presentation is that it is essentially descriptive. He draws on a wide variety of primary sources and weaves an absorbing tale. His theme, as far as I can determine, is that the conception of the Bretton Woods agreements was based upon the need to complement the war effort. Given this perceived need, plans were drawn up by technicians and were later sold to Congress and influential elements of the public. These plans had an increasingly limited analytical connection with the needs of the postwar period.

Eckes does not offer much interpretation or analysis of the 1941-1945 period. This is just as well because analysis is not his strength. For example, on the so-called gold standard system, Eckes would like to think that it operated prior to World War I according to the textbook description, but he also realizes that it did not. The resulting confusion produces a rather incoherent treatment of the interwar period. Eckes also asserts that at the time of Bretton Woods the United States "stood to benefit more from currency stabilization than many countries," although he recognizes that it was less dependent on trade. This assertion is not, however, substantiated. Finally, Eckes spends what for my taste is too many pages on the subject of the political preferences of Harry Dexter White and the supposed leftward tilt of the U.S. Treasury. The point of these digressions is apparently to permit Eckes to conclude that he has confirmed "the oft-neglected pro-Soviet stance of Treasury policy" at the time of Bretton Woods--a conclusion that would at best require a more detailed study to substantiate convincingly.

When Eckes comes to the postwar era, his treatment is weak and drawn entirely from secondary sources. The jacket of the book makes the promise that he will "explain the origns of today's global inflation and currency problems." This promise is not kept. Eckes argues that in 1971 "the breakdown of monetary arrangements occurred, as monetarists anticipated a quarter-century earlier, from differential rates of inflation." The major piece of evidence offered in support of these assertions is the opposition of Henry Simons to the Bretton Woods Agreements in 1945. No mention is made of the fact that the IMF staff had a strong monetarist slant before this approach became fashionable.

On the accomplishments of Bretton Woods itself, Eckes also fails to present a unified judgment. He argues that "Keynes was prescient and his American opponents myopic in rejecting the British plan," but he goes on to argue that the Keynes plan was an "inappropriate and imprudent approach to postwar monetary problems." His verdict on the Bretton Woods institutions is similarly ambiguous. Fortunately these flaws do not detract substantially from the value of the book to historians of the 1941-1945 period.

Bergsten's The Dilemmas of the Dollar is in essence a sequel to Robert Triffin's Gold and the Dollar Crisis (New Haven: Yale University Press, 1960.) Triffin predicted the demise of the gold-exchange standard, and Bergsten details its demise. Triffin offered a plan of reform, which concentrated on the reserve asset system, and Bergsten brings it up to date, at least he brings it up to 1973. Despite Bergsten's claims, his vision, like Triffin's, embraces only limited exchange-rate flexibility.

Bergsten's book is crammed with material; unfortunately, it is not always well organized and his assertions often are unsubstantiated. Bergsten's viewpoint is that "U.S. international monetary policy can only be effectively understood through an analysis of the dollar's international roles, and of the perception of these roles and the outlook for them held by U.S. officials." At some points in the book, Bergsten is very precise about what he means by the dollar's roles. He means the vehicle, intervention and reserve roles of the dollar, and his reform plan is directed primarily at eliminating or drastically reducing the last role. This according to Bergsten is the source of the dollar's basic dilemma which is that the United States cannot afford to live up to the economic-policy demands that are placed upon a key-currency country if it is to retain a viable reserve-currency status for its currency. At other points in the book, Bergsten is very imprecise about what he means by the roles of the dollar. He speaks of the need to reduce the key-currency roles of the dollar. On the same page (116) he speaks of the demand for key currencies, the declining financial role of a currency, and the dollar's share of world finance. The use of such vague terms does not help to elucidate the dilemmas of the dollar.

Some of the best portions of the book are those where Bergsten examines in general terms the political side of international finance. But often his economic analysis is either wrong, strained, or unsubstantiated. He builds an elaborate structure of the postwar monetary system as a tripartite division of countries passing through four historical phases. Membership in each parts based on a country's marginal preferences regarding the composition of its reserves: gold, sterling or dollars. (The evidence Bergsten uses to establish the existence of a gold bloc is rather tenuous, and he never satisfactorily explains why these countries--Austria, Belgium, France, Italy, The Netherlands, Portugal and Switzerland--should have a high marginal preference for gold.) The objective of this exercise is to enable Bergsten to reach the conclusion that after 1971 the dollar was repudiated (his word) and that this represents a dilemma for the dollar and not for the international monetary system.

Bergsten's handling of historical material is often haphazard. For example, at one point he explains the 1965 shift in the U.S. position toward support for the establishment of a supplementary reserve asset (which became the Special Drawing Right (SDR) in terms of the attacks on the dollar by the French. At another point in the book, he attributes the change in U.S. policy to the decline below 1.0 in the ratio of U.S. reserves to short-term dollar holdings by foreign official agencies. Both explanations are oversimplified, especially when considered separately. To cite another example, Bergsten describes the third phase of his chronology (the *de facto* dollar standard of 1967-1971) and the U.S. policy of benign neglect without once mentioning the change in U.S. administrations as a contributing factor. (The reader interested in a richer and more careful treatment of the postwar evolution of the international monetary system is advised to read Robert Solomon's The International Monetary System 1945-1976: An Insider's View (New York: Harper and Row, 1977).)

Bergsten's economic analysis is also weak in places. For example, in an otherwise careful analysis of the costs of adjustment where he standard-aralizes his comparisons of alternative adjustment techniques on a $5 billion change in the U.S. current account, he argues that the costs will be smaller if another country acts because the effects will be diffused. Bergsten is also puzzled by the "anomalous combination" of the U.S. surplus on official reserve transactions in 1973 with the decline in the dollar's exchange value. His explanation appeals to the mysterious influence of the "dollar overhang" (see below). He need only to have observed that foreign official agencies were net sellers of dollars and, thus, were increasing the supply that the market had to absorb; this was the counterpart of the U.S. surplus. To cite a final example, Bergsten at times defines an "equilibrium exchange rate" for the dollar as one that leads to a U.S. current account surplus and a reduction in U.S. protectionist pressures. His politics may be accurate, but he can't use economics to prove his point.

As was mentioned above, Bergsten's reform proposals are based upon the assumption of a system of limited exchange rate flexibility. In support of this approach he asserts without proof that controls have proliferated since the advent of more flexible exchange rates. (Bergsten also criticizes the Committee of Twenty for not going beyond its formula of stable but adjustable par values with limited floating, but he does not himself offer much more guidance than the C-20's reform outlines.) He also places great emphasis upon the importance of eliminating the threat from the dollar overhang through a limited consolidation of dollars into SDR through the IMF. This device would allow a substantial reduction in the reserve role of the dollar.

Bergsten's definition of the dollar overhang includes both the reserve currency balances held by foreign monetary authorities and the private transactions balances held by foreigners. But if the latter are to be included in the overhang, then the transaction balances held by U.S. residents should be also. Bergsten fails to recognize that he is dealing with two potential problems. The first problem is that foreign monetary authorities might unload their dollars at an inopportune time for the United States, depress the dollar's exchange rate, and inflate the U.S. economy. This is a real problem, although no one can say what the chances are that it will occur--Bergsten notes that the most significant fact about the overhang in 1971 was that it did not collapse. Consolidation of official dollar balances could solve this problem. The second problem is that capital is now more mobile internationally than it once was and private individuals can attempt to move large sums between currencies. This is also a real problem, but provision for the consolidation of privately held foreign balances of dollars would do little to solve it--domestic balances are much larger and a large portion of them is very mobile. This problem is a function of the realities of the international economy, not of the private overhang per se. A third problem that Bergsten does not recognize is countries' growing use of private credit to finance payments imbalances. This generates an overhang, if you like, of dollar-denominated debt issued by countries other than the United States. The value of the dollar may be depressed as this overhang builds up and inflated if it is reduced.

These criticisms of Bergsten's book are not intended to detract from its overall worth. It is a useful and stimulating book despite its special thesis and its flaws. One example of an interesting theme is Bergsten's argument that in the late 1960s there was a convergence toward an SDR-based system incorporating more flexible exchange-rate arrangements. This convergence was stalled. He also discusses the possibility of crowning an inconvertible dollar at the center of the international monetary system. He argues that other countries would not accept such a regime and that they and the market would look for other more congenial currencies to serve their purposes. But we may be close to a crowning of the dollar. Finally, Bergsten lays down five principles for a systemic reform: it must be managed internationally; it must accommodate diversity; it must be based on the SDR with holdings of other reserve assets permitted only under rules to prevent adverse effects on the system; it must have an improved adjustment process; it must be based on real cooperation among countries. How close are we to satisfying Bergsten's five principles? On paper, the second amendment of the IMF Articles of Agreement comes close to satisfying all but the third. How important is it to resolve the potential problem of the official dollar overhang? Bergsten thinks it is very important, and he notes that U.S. monetary authorities are still ambivalent about the role of the dollar and the perceived threat of potential competitors to its dominance.

Money and the Coming World Order is a little book containing four essays about the future of the international monetary system and the direction of needed changes. The essays do not rely on historical material nor are they very profound. They are contemporary examples of what four people think about this topic.

Harold van B. Cleveland's essay is the shortest of the four, and he makes two provocative points. First, he is reasonably satisfied with the present organization of the international economy and does not look for much change. He calls it a stalemate system. Second, he thinks the international monetary system has not changed much since the 1960s; it is still an inconvertible dollar standard, though with a little more exchange-rate flexibility. Cleveland may be the only person alive who holds both of these views.

Charles P. Kindleberger emphasizes his familiar theme of leadership. He attempts to explore the bases for international economic organization. After rejecting altruism, enlightened self-interest, rules and regional blocs, he arrives at the positive (in contrast with normative) solution of leadership. He notes, however, that the United States dumped its obligations of leadership in 1971. He would like the United States to pick them up again because he sees no other viable candidate. Kindleberger, however, discusses no incentives for the United States to pick up these burdens, other than altruism and enlightened self-interest.

I do not quite know how to deal with an essay like David P. Calleo's where monetary systems are described as "essentially a sort of metaphor for general political-economic relations in the world system." I suppose one might overlook such excess in the use of language except that the analysis in the essay is also weak. For example, recycling by OPEC is called foreign aid; dirty floats, by which Calleo means managed floats, are equated with competitive depreciations; Germany and Japan are supposed to become protectionist when they stop supporting the dollar; and a general move toward protectionism is regarded as inevitable. Calleo's solution is an "automatic plural system" based on rules. He is partial to a Rueffian system based on an updated gold standard.

Lewis E. Lehrman presents the longest essay. Having been convinced by Mundell of the virtues of a single world money, and having been convinced by the analytically correct, but practically unsubstantiated, arguments of Laffer that exchange-rate changes serve no useful purpose, Lehrman is an unabashed fan of permanently fixed exchange rates. He believes they will bring about low inflation rates through the exercise of domestic discipline. He understands, however, that his system of convertibility will require coordination of national economic policies. He believes that a world monetary system under U.S. leadership will "coincide with the end of inflation in the Western world." Who is to say that he is mistaken?