Was the post-war international trade order bound to succeed while the Bretton Woods monetary order established in 1944 was doomed to fail?

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Abstract
This paper explores the reasons embedded in the original architecture of both the international trade and monetary regimes that determined different outcomes for both. It proposes that the original version of the Bretton Woods monetary regime showed faster its essential failures and basically had to be replaced as early as 1971, while the trade regime embodied in the GATT and later in the WTO managed to at least survive until present day. It posits that correspondence (or the lack of it) of the basic characteristics of the said regimes with the underlying political reality where the regimes would apply (in line with Ruggie’s depiction of «embedded liberalism») accounts for the differentiated outcomes. It explains that the international trade regime showed more flexible traits that allowed it to adjust to the underlying political and led to its survival. The lack of that adaptability element would likewise explain the early demise of the original Bretton woods scheme.

Keywords: international trade regime, international monetary regime, GATT, WTO, IMF, Bretton Woods, embedded liberalism, foreign trade policy, international monetary policy, institutional flexibility

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¿Estuvo el orden del comercio internacional de la posguerra dirigido al éxito mientras que el orden monetario de Bretton Woods establecido en 1944 estaba signado por el fracaso?

Resumen
Este trabajo explora las razones incorporadas en la arquitectura original de los regímenes internacionales de comercio y monetario que determinaron los distintos desenlaces para ambos. Propone que la versión original del régimen monetario de Bretton Woods mostró más rápidamente sus fallas esenciales y tuvo que ser remplazado tempranamente en 1971, mientras que el régimen internacional de comercio logró al menos sobrevivir hasta ahora. Postula que el alineamiento (o la ausencia de este) de las características básicas de dichos regímenes con la realidad política subyacente sobre la cual deberían aplicarse esos regímenes (en la línea de la descripción de Ruggie del concepto de embedded liberalism) explica la diferenciación en los resultados. Explica que el régimen internacional de comercio reveló caracteres de mayor flexibilidad que le permitieron ajustarse a la realidad política subyacente lo que llevó a su sobrevivencia. La falta de ese elemento de adaptabilidad explicaría igualmente el temprano deceso del esquema original de Bretton Woods.

Palabras clave: régimen del comercio internacional, régimen monetario internacional, GATT, OMC, FMI, Bretton Woods, embedded liberalism, política de comercio internacional, política monetaria internacional, flexibilidad institucional.

1. Introduction

In this essay I will try to defend the idea that the GATT survived, luckily for itself a much happier outcome than the one which History had reserved for the original Bretton Woods monetary order, because the de facto international trade organization of GATT and its rules were a better reflection of the underlying principle of «embedded liberalism» (the consensual common pillar to both agreements). The concept of embedded liberalism used in this paper is understood in the terms of John G. Ruggie’s famous article (1983, p. 195), as the compromise of reconciliation between market and society in the following terms:

This was the essence of the embedded liberalism compromise: unlike the economic nationalism of the thirties, it would be multilateral in character; unlike the liberalism of the gold standard and free trade, its multilateralism would be predicated upon domestic interventionism. (1983, p. 209)

I can’t stress enough the appropriateness of the use of the word «survived» as I will also try to make the point that the story following the establishment of GATT can hardly be described as a success. In any case, if compared to the WTO parcours the GATT could boast a level of achievement regarding the trade liberalization rounds it hosted between 1947 and 1994 which the WTO simply cannot match.
Exactly what do I understand for «the international trade order which survived» and what is my definition of the monetary order which ceased to be?

The question is pertinent as it could be argued that the 1994 Marrakesh Protocol was, at the same time, GATT’s death sentence and the birth certificate of a much-needed comprehensive WTO, able to enforce discipline against the threats posed by New Protectionism.

Conversely, I will also have to explain what do I understand by failure of the Bretton Woods monetary order for the IMF is still alive and kicking and a witty devil’s advocate could allege that August 1971 and the ensuing demise of the gold window and the sanctioning of flexible exchange rates were just a reordering within the system.

These definitions constitute the first issue I will tackle and after having clearly defined what is it that I understand for both the «surviving post-war international trade order» and the «dead Bretton Woods monetary order», I will address the question of why the evolution of the GATT after its creation in 1948 can hardly be defined as a success.

Having established my parameters of the differentiated outcome characterising the GATT and Bretton Woods stories, I will then consider the explaining factors, mainly drawing from interpretation of historic events.

Finally, the necessary conclusions to be drawn from such an explanation will be used to highlight the main elements that answer the opening question that provides the title for this paper.

2. Who Died and Who Survived?

The Bretton Woods Agreement signed in July 1944 tried to answer the two fundamental questions which need to be addressed by an international monetary system: liquidity provision and adjustment (which also refers to the exchange rate stability issue).

As Joanne Gowa correctly points out, reality determined a departure of the system from what had been envisioned by the original blueprints (1983, p. 34).

I will consider the liquidity issue first.

Gowa (1983) stresses on the theoretical role of an expanding supply of gold to international markets.
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Eric Helleiner (2008), on the other hand, probes a little deeper into the mechanics of international payments and states that, within the Bretton Woods theoretical architecture, liquidity provision for trade and growth was a role reserved to the IBRD (World Bank). In such a view, this bank was originally designed to finance Europe’s reconstruction and its imports from the US needed for this reconstruction effort.

This same line of reasoning seems to be behind Walter’s assessment of Hegemonic Stability Theory and US-Europe relations where he underscores that the Bretton Woods system had effectively collapsed in 1947 and that the role of the US in the international monetary system was established outside the formal structure of the Bretton Woods agreements (Walter, 1996, p. 134).

It is not clear, however, that the Bretton Woods’ negotiators were actually relying on the IBRD for this role. As Richard Gardner points out both the British and American negotiators had a very conservative approach to the Bank’s role and the institution which emerged from the negotiations included provisions regarding the payment of member subscriptions and a cautious lending policy that closely limited its role as an independent lender (Gardner, 1980, p. 118).

It doesn’t seem likely, therefore, that the Bretton Woods architects were relying on such a diminished entity to provide for world liquidity.

What seems, however, sufficiently clear to be stated safely is that whatever we regard as the theoretical source of the system’s liquidity it was bound to prove insufficient.

This assertion can also be extended to the IMF’s resources, although it must be noted that the sort of liquidity that the IMF was supposed to provide was a temporary overdraft facility for member states in balance of payments difficulties, not the liquidity required for the expansion of international trade which was supposed to translate itself into the world’s economic growth.

In any case, as I have stated, reality proved a departure from theory and reality proved that liquidity provision throughout the life-span of Bretton Woods became a role assigned to the United States, first, in the days of the US trade surplus, through American foreign investment and aid, and later, in the days of US trade deficit, through the rest of the countries’ willingness (due to self-interest or American pressure) to accumulate dollar reserves.

As for the second essential element of the international monetary order, namely the stability element (and adjustment to preserve stability) this was placed on the shoulders of the adjustable peg mechanism, as stated in the Articles of Agreement of the IMF.
Adjustment however, remained a tricky issue within the Agreements with the lack of definition of «fundamental disequilibrium» in the balance of payments as the enabling condition to proceed to exchange rate adjustments.

Ambiguity in the Agreement regarding adjustment was furthermore increased by failure on clear allocation of debtor-creditor adjustment responsibility and feeble provisions on the Fund’s surveillance on national policies (despite the fact that the Agreements relied on internal changes in prices and incomes of countries for long-term equilibrium in the balance of payments).

Again, reality outsmarted theory and Bretton Woods became, as Gowa underlines, a fixed exchange rate system, with countries unwilling to proceed to adjustments because these constituted a sign of political failure.

As much as deviations occurred, as Germany’s Deutsche Mark revaluation in 1961, the Netherlands’ Guilder doing likewise that same year and the floating of the Canadian Dollar since 1950 (although it was repegged in 1962), these exceptions can be understood as a confirmation of the rule and as John Williamson (1977, p. 6) has observed then followed a period when exchange rate changes were relegated to the status of confessions that the adjustment process had failed, and an attempt was made to operate a fixed rate system as for a period of more than five years, between 1962 and 1967, not a single major country altered its currency’s parity.

Therefore, I follow Gowa (1983, p. 37) in stating that the United States as the key currency country (imposing on the United States both the obligation not to inflate unduly and to act in the interests of the system as a whole) and a fixed exchange rate are the two characteristics which define the Bretton Woods system which, effectively, died the night of August 15, 1971 with the Nixon announcement of the end of gold convertibility.

It is true that the adjustable peg exchange-rate regime actually broke down in 1973 but as Harold James (1996, p. 227) implies, the unilateral action by the US in August 1971 undoubtedly signalled the preponderance of domestic concerns over international collaboration. This unwillingness of countries to make adjustments would only lead to practical impossibility to negotiate new parities and so the times of floating rates had finally arrived.

Therefore, I choose the US unilateral action of ending convertibility in 1971 as the date of the Bretton Woods funeral.

As for my understanding of the concept of post-war international trade order I define it as the set of tariffication disciplines, mostly embodied in the GATT 1947 instrument and the subsequent tariff reduction and trade liberalisation negotiations.
pursued in the successive rounds preceding the Uruguay Round and the creation of the WTO.

In other words, by post-war international trade order I understand the trade related disciplines and the *de facto* international organization charged of enforcing and expanding those disciplines which was subsequently superseded by the WTO.

3. **Can the GATT story be defined as a success?**

The GATT story can only be characterised as a success if analysis is circumscribed to the period of the «trade boom» which characterised the 1950s and 1960s in which, according to Bhagwati (1988), a mutually reinforcing relationship between trade liberalization and economic performance accounted for increased world output.

There is consensus in attributing to the GATT the sponsoring of this trade liberalization process, finding its highlights in the tariffication disciplines agreed under GATT 1947 (essentially the general prohibition of quantitative and other non-tariff restrictions to trade) and the successive tariff-reduction rounds completed under the aegis of GATT.

I still believe, however, that not a small portion of benevolence is needed to accord the adjective «successful» to the GATT, even during the aforementioned period.

After all, as Gilbert Winham correctly points out «the early GATT tariff negotiations were multilateral in name, but in fact the real action occurred bilaterally between nations that served as principal suppliers and principal consumers of each other’s products» (2008, p. 96) This is an idea also supported by Milner (1998, p. 137).

Furthermore, as also remembered by Winham

> [...] the Kennedy Round of 1963-7 emerged as the first significant negotiation in GATT after the initial negotiation in 1947. It led to an average tariff reduction among the participants of about 35 per cent, in sharp contrast to the reduction of less than 10 per cent on a much smaller volume of trade in the Dillon Round that preceded it, or even the 20 per cent reduction achieved in the negotiation of 1947. (2008, p. 97)

To all this I must add the drifting of agriculture away from the GATT system, initiated by the 1955 US waiver for its Agricultural Adjustment Act and gradually followed by the rest Contracting Parties. This process reached its peak with the European Communities’ Common Agricultural Policy (CAP), but that is another story.

Besides, it must also be remembered that the equivalent to the Bretton Woods organizations was the intended to be International Trade Organization. For a fair post-war financial order vs. post war trade order comparison, this would actually have to
be done regarding the complete failure of the birth of the ITO, allegedly the most important leg of the post-war international economic tripod.

There is also relative consensus in considering that by the end of the Tokyo Round, New Protectionism was the dominant trend in trade policies (the five new codes of conduct agreed did not succeed in slowing the use and abuse of non-tariff procedures) and by the mid-80s there was a widespread feeling that the world trading order seemed to be on the verge of disintegration (Grilli & Sassoon, 1990).

It is also true, however, that the GATT trade order didn’t crumble and that the 35 year-old tradition of mutual concessions and bargaining managed to reinvent itself as the WTO.

Therefore, what can be safely stated about the GATT story is that it was a story of relative progress and resilience if assessed against the benchmark of its purported liberalization goal. It managed to survive to successfully negotiate its transformation through the Uruguay Round. Only up to the point in which relative liberalization and survival can be associated with success is the GATT story a successful one. As already stated, if compared to the current WTO’s stalling that assessment of the GATT’s performance could be substantially enhanced.

4. Searching for the Reasons Why

My main argument in this paper is that the GATT system survived, as opposed to the monetary order of the Bretton Woods system because the latter had an architecture which was better suited and more flexible to changes in the international economic reality.

I have also contended that, theoretical considerations apart, the original Bretton Woods system was in reality underpinned by the US role as key and reserve currency of the system and, stimulated in part by the ambiguity of the IMF Agreement on adjustment; the second essential characteristic of the system was that of a fixed exchange rate system.

Both these characteristics constituted two increasingly burdensome built-in inflexibilities of the system and neither of them was consistent with the breathing space for national policy autonomy which the embedded liberal compromise was supposed to furnish.

In the case of the United States, Jeanne Gowa illustrates how the US was finally forced to recognise that the priority it placed in domestic and foreign security policy had become incompatible with the maintenance of the Bretton Woods system:
Absent from the long series of US efforts to restrain its balance of payments and preserve the postwar monetary regime is any serious or consistent compromise of the objectives of domestic macroeconomic policy or foreign security policy. While the US clearly had an interest in preserving the monetary regime, that interest did not supersede the importance of maintaining autonomy of action in these two policy areas. Its hierarchy of objectives was clear and consistent: ranked above the survival of Bretton Woods was the US ability to respond freely to the perceived needs of its domestic economy and its foreign policy. (1983, p. 47)

As much as the US role was central to the maintenance of the Bretton Woods system I am not endorsing either of the variants of the Hegemonic Stability Theory: the fixed exchange rate obligation was a constrain on all the players of the game and there was a relative consensus in not abiding to the related disciplines it imposed, such as not recurring to expansive policies and submittance to international surveillance.

Starting in the 1960s there was an increasing trend among countries in resorting to expansionist policies which all countries tried to implement as economic issues started playing a major role in elections. As noted by Harold James (1966)

As a result of the new importance —in national political discussions— of the regulation and control of growth and employment, the political sensitivity of governments to economic issues increased. In consequence, their willingness to undertake adjustment as a response to international pressure diminished. (p. 177)

Related to this trend, and also significative was the increasing distaste among the key players of the system to become subject of international surveillance in economic matters. Again, James illustrates this:

With the adoption of what was in practice a key currency system, the operators of the reserve currencies (the United States and the United Kingdom) became unwilling to accept the principle of surveillance and able for long stretches to ignore its implications. When the result of ignoring persistent payments imbalances became evident, it would, as a consequence, inevitably take the form of a sudden swing in confidence and the outbreak of a crisis. (1966, p. 204)

This feature was not circumscribed to the reserve currency countries but also applied to the rest.

Furthermore, another trend in the evolution of the international economic reality during this period also revealed the degree of policy inflexibility rendered by the fixed exchange rate system.

The shift of the major economies towards the privileging of national economic concerns over the constraints imposed by the international monetary system translated itself into uncoordinated national policies and thus, exacerbation of differences in national performance. Naturally, international speculation, boosted by the
development of the Eurocurrency markets and increasing international inflation since the 60s, appeared as a fundamental destabiliser.

Having depicted how unfit the Bretton Woods international monetary system was to face its challenges, it is not hard to identify the relative flexibility of the GATT system, defined in the same terms I have used for the monetary realm.

The tariff-cutting negotiating forum was free of a corset analogous to the fixed exchange rate system and didn’t rely to the same extent on the role of the United States.

It was therefore natural for the players to continue using this forum, especially with its successful record in tariff-cutting during the 60s. As I have already stated, its reinvention as the WTO to cope with New Protectionism and widening and deepening its scope is part of a different story.

5. Conclusions

The Bretton Woods system sanctioned in 1944 was an adjustable exchange rate system which didn’t provide adequately for the liquidity needed even for temporal adjustments in balance of payments and ambiguous in its assignment of adjustment responsibilities.

Reality gave birth to a system in which liquidity relied on the key currency which proved too strenuous for US domestic economic and foreign policies.

Related to this liquidity issue is the fact that the US key currency role provided for a gradual impotence of the US (and the rest of the players) to deal with the soar in liquidity brought about by the increasing importance of private capital markets and speculative flows.

As for the second main characteristic of the Bretton Woods system in practice it developed into a fixed exchange rate system.

The second of these characteristics proved too much not only for the US but also for the ensemble of the players, on the light of the evolution of the international monetary scene.

The GATT, defined as a tariff negotiating forum with tariff related disciplines didn’t suffer from the same inflexibility. Enough room was provided for safeguards and escape clauses. As has been stated elsewhere, where the Americans read Articles I and III (MFN and National Treatment), Europeans read Article XIX (Safeguards) and this maintained its usefulness as a negotiating place.
Such a trait corresponded much better and made it consistent with the «embedded liberalism» paradigm.

References


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