International Monetary System

Bretton Woods system
(1945-1972)

Introduction

- It was clear during the Second World War that a new international system would be needed to replace the Gold Standard after the war ended
- The design for it was drawn up at the Bretton Woods Conference in the US in 1944
- After the chaos of the inter-war period there was a desire for stability, with fixed exchange rates seen as essential for trade, but also for more flexibility than the traditional Gold Standard had provided

Bretton Woods System (1945-1972)

- The Bretton Woods Agreement was negotiated in July 1944 by delegates from 44 countries at the United Nations Monetary and Financial Conference held in Bretton Woods, New Hampshire

- Thus, the name "Bretton Woods Agreement"

Bretton Woods System (1945-1972)

- Under the Bretton Woods System, gold was the basis for the U.S. dollar and other currencies were pegged to the U.S. dollar's value

- The Bretton Woods System effectively came to an end in the early 1970s when President Richard M. Nixon announced that the U.S. would no longer exchange gold for U.S. currency

Bretton Woods System (1945-1972)

- During the era of the Bretton Woods system, the world economy grew rapidly
- Keynesian economic policies enabled governments to dampen economic fluctuations, and recessions were generally minor
- However, strains started to show in the 1960s
- Persistent, albeit low-level, global inflation made the price of Gold too low in real terms

Bretton Woods System (1945-1972)

- A chronic US trade deficit drained US gold reserves, but there was considerable resistance to the idea of devaluing the dollar against gold; in any event this would have required agreement among surplus countries to raise their exchange rates against the dollar to bring about the needed adjustment
- Meanwhile, the pace of economic growth meant that the level of international reserves generally became inadequate; the invention of the 'Special Drawing Right' (SDR) failed to solve this problem

The IMF and World Bank

- The Bretton Woods Agreement created two Bretton Woods Institutions, the IMF and the World Bank
- Formally introduced in December 1945 both institutions have withstood the test of time, globally serving as important pillars for international capital financing and trade activities
- The purpose of the IMF was to monitor exchange rates and identify nations that needed global monetary support

The IMF and World Bank

- The World Bank, initially called the International Bank for Reconstruction and Development, was established to manage funds available for providing assistance to countries that had been physically and financially devastated by World War II
- In the twenty-first century, the IMF has 189 member countries and still continues to support global monetary cooperation
- Tandemly, the World Bank helps to promote these efforts through its loans and grants to governments.

Collapse of Bretton Woods System

- In 1961 the London Gold Pool was formed
- Eight nations pooled their gold reserves to defend the US$35 per ounce peg and prevent the price of gold moving upwards
- This worked for a while, but strains started to emerge
- In March 1968, a two-tier gold market was introduced with a freely floating private market, and official transactions at the fixed parity
- The two-tier system was inherently fragile

Collapse of Bretton Woods System

- The problem of the US deficit remained and intensified
- With speculation against the dollar intensifying, other central banks became increasingly reluctant to accept dollars in settlement; the situation became untenable
- Finally in August 1971, President Nixon announced that the US would end on-demand convertibility of the dollar into gold for the central banks of other nations
- The Bretton Woods system collapsed and gold traded freely on the world's markets

Thank You