Trade, Currency, and International Cooperation

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Benn Steil, The Battle of Bretton Woods: John Maynard Keynes, Harry Dexter White, and the Making of a New World Order (Princeton University Press, 2013).

It's always nice when you can combine outside reading for fun with something that is educational and at least indirectly professionally relevant. Benn Steil's economic and diplomatic history of the 1944 Bretton Woods conference, which established the post-World War II global framework for currency relationships and international trade (while also creating the International Monetary Fund and the World Bank) filled this niche for me during a quiet weekend. While the subject is not literally or directly related to taxation, it touches so closely on finance, macroeconomic policy, and international trade as to occupy a common universe with overlapping concerns.

The book tells a lively story, in which U.S. Treasury economist Harry Dexter White – an ardent economic nationalist yet also a Soviet mole – thoroughly squelched the great English economist John Maynard Keynes (the U.K.'s chief negotiator) in establishing the postwar regime for trade, currency, and capital flows. With the U.S. economically dominant and the U.K. reduced to begging for loans, Keynes would have had no chance even had he been better at converting his analytical and epigrammatic skills into diplomatic ones.

The resulting Bretton Woods framework (which lasted until 1971, when President Nixon abruptly canceled the dollar's fixed-rate convertibility to gold) responded to the view that, in the 1930s, trade wars and competing currency devaluations had both prolonged the Great Depression and helped set the stage for World War II. But it also helped to ensure the dollar's hegemony and to advance the U.S.'s interests as a dominant creditor nation that favored open markets, global currency stability, and an end to the U.K.'s hopes of restoring its own prewar position.

In terms of broader takeaways, Steil shows how difficult, unresolved, and relevant to our own very different era the underlying issues were. Three basic global currency models were competing for primacy:

• Gold standard: This had worked pretty well in the nineteenth century, but was fingered by Keynes as a prime cause of the horrific 1930s global macroeconomic experience, and has few adherents today. The core idea behind it is that, stupid and arbitrary though it may be to shackle national macroeconomic policy to one's holdings of an inert metal, shackling can at least reduce discretion that one fears would be misused.

A key question, of course, is *how* discretion would be misused. Those who fear that governments will under-respond, not over-respond, to persistent unemployment – a problem both in the 1930s and today – may view the shackling as only making things worse. And if governments that cannot dispense with gold convertibility don't sufficiently anticipate the problems that falling gold supplies would cause them, then the gold standard, rather than offering a useful constraint, may simply ensure bumpier landings.

• Active management by experts of trade balances, capital flows, and relative currency values: Keynes believed that pure free trade and allowing unrestricted cross-border capital flows had been as

completely discredited as the gold standard by the experience of the 1930s. And as for allowing national currencies simply to float against each other on global markets, this did not need to be discredited, as it had not yet become widely credited. Today, most mainstream views are more pro-market than Keynes was, and place less faith in rule by experts. However, his concern that countries' national policy aims might be undermined by unfettered trade and capital flows, and by changing relative market values for competing currencies, remains pertinent. The policy aims that potentially may be undermined range from tax enforcement, to maintaining full employment and high wage levels, to addressing internal distributional concerns, to limiting one's exposure to the inbound transmission of financial panics.

• The dollar-based Bretton Woods model: The deal that came out of Bretton Woods, pushed through by the U.S. via brute force rather than intellectual consensus, effectively made the dollar and gold co-equal global "gold standards" (so to speak) for monetary wealth-holding and cross-border trade. The U.S. proved unable, however, to keep one foot on each of the two barrels that Bretton Woods required it to straddle: basing dollar issuance both on the level of Fort Knox reserves that we were ready and willing to exchange for dollars, and on our own national policy needs or preferences.

Yet the dollar's global preeminence as a reserve currency has survived the end of gold convertibility – contrary to what anyone in 1944 would have expected, especially if they had foreseen the Nixonian quasi-default. We continue to benefit from the dollar's global position, unless one regards seigniorage and our continued ability to borrow at low interest rates in our own currency as merely giving us more rope with which to hang ourselves in the end.

While people increasingly question the dollar's ongoing viability as the global reserve currency, no rivals are discernibly on the horizon. The Euro's decline arguably suggests that Keynes was too sanguine in believing that multinational institutions could manage a global currency when national governments retained separate policy discretion. If the Euro can't work, what chance would a truly global currency – advocated by Keynes pre-Bretton Woods, and more recently by Chinese leaders – realistically have? And the Chinese renminbi seems unlikely to attract or deserve widespread dollar-like trust anytime soon.

As Steil discusses at the end of this good read that is also good for you, if the dollar loses its current global status and no substitute reserve currency emerges, not just the U.S. will suffer. He notes that China, our leading creditor, holds U.S. government securities worth more than $1,000 per resident. Thus, China's clear motivation to challenge a global status quo that favors our interests is offset by a "mutual assured destruction" problem. They cannot sink the dollar without giving themselves a gigantic punch in the nose. Steil closes by noting, that, while the U.S. and China therefore have every reason to work constructively together through the next few decades' political and economic challenges, the same was true of Germany and England just over 100 years ago, as they sought to recalibrate their relationship in light of Germany's global ascent. We know what happened that time around.

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