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Books: A Fateful Meeting That Shaped the World

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The Battle of BrettonWoods

By Benn Steil

Princeton, 472 pages, GBP 19.95

One of the many merits of "**The Battle of Bretton Woods**," a superb history of mid-20th-century monetary affairs, is the timing of its publication. Today, as never before, central banks are printing money, suppressing interest rates and manipulating markets. You wonder where it will all end.

Where it began is easier to reckon. The U.S. Federal Reserve, which its founders wouldn't recognize if they were brought back to life to inspect their handiwork, came into the world to mobilize credit and forestall financial panics. In 1913, the year of the Fed's founding, the dollar was defined as slightly less than 1/20th of an ounce of gold.

The 1944 conference at Bretton Woods, N.H., Benn Steil's subject, was another government initiative to regulate money and banking. Representatives of 44 nations trekked to the Mount Washington Hotel to design a framework for the world's currencies, not least the dollar, which was by then defined as only 1/35th of an ounce of gold. America's Harry Dexter White and Britain's John Maynard Keynes talked and tussled and produced the set of arrangements that lasted, in one form or another, until 1971.

Nowadays the dollar is undefined and unanchored. It commands such value as the not-quite-free market sees fit to endow it with, at this writing slightly more than 1/1,600th of an ounce of gold. With respect to its gold value, the greenback has become nearly invisible, like the interest you earn on your savings.

Mr. Steil, a senior fellow at the Council on Foreign Relations, is a talented storyteller. If, perhaps, he lingers too long over just how White's bad thinking differed from Keynes's bad thinking, or why the State Department was mad at the Treasury Department, and vice versa, he more than compensates with the nontechnical fluency of his economic narrative and the engrossing portraits of his two principal characters.

Who was the more disagreeable, it's hard to say. White, a senior American Treasury official, freelanced as a Soviet spy. His personal style was incivility. Keynes, among the first of the modern celebrity economists, devoted himself to promoting schemes to aggrandize state power and wangle dollars for the broke British exchequer. His personal style was condescension.

White is the less familiar of Mr. Steil's odd couple. A late bloomer, he earned an undergraduate degree in economics from Stanford at the age of 32 (he had worked in the family hardware business and served as a lieutenant in the Army in World War I before returning to school) and a Ph.D. from Harvard at the age of 38. His professors accounted him brilliant. He taught for a time at Lawrence College in Appleton, Wisconsin, before being summoned to Washington, in 1934, to assist in drafting the Roosevelt administration's long-range economic agenda. Later, as a top assistant to Treasury Secretary Henry Morgenthau, White proved a model civil servant not to one government but to two. He spied for the Soviet Union and ardently, if discreetly, supported the Soviet system. "Russia is the first instance of a socialist economy in action," the bureaucrat wrote in an unpublished essay that Mr. Steil discovered in White's papers. "And it works!"

Unmasked, White was called to testify before the House Un-American Activities Committee in 1948. He stoutly lied under oath. Shortly after testifying, he suffered a heart attack and died. Long after his death, decrypted Soviet cable traffic proved what HUAC could not: White was a Red. As for his economics, anyone would have thought that they were Keynesian, not Marxist. That is, White publicly prescribed, the government should control and direct the means of production, not own them.

No particular brand of economics could have easily held the attention of the delegates to Bretton Woods in the tumultuous summer of 1944. Thousands of miles from their deliberations, Allied troops were battling inland from the Normandy beaches and U.S. Marines were landing on Saipan. Still, the U.S. Treasury pushed ahead with planning for the postwar economic world. More's the wonder that the initiative actually produced a plan and the institutions with which to carry it out. The plan's essence: to fix the value of money while giving governments every opportunity to unfix it.

Nostalgia plays tricks on memory. The Bretton Woods period was prosperous, all right -- especially so the "Mad Men" era of the early and mid-1960s -- but how much of that success was attributable to White's and Keynes's monetary invention is debatable. Perhaps the best that can be said of the intricate Bretton Woods machinery is that it was an improvement over anything on offer in the 1930s.

In his descriptions of contending monetary ideas, Mr. Steil is at his best and his book is at its most relevant. Today's arrangements, with their "quantitative easing" and wandering exchange rates, seem fragile and impermanent compared with the classical gold standard. If they are in fact not long for this world, what might replace them?

Gold figures largely in these pages. The ancient metal was deeply rooted in the psyche of Keynes's contemporaries, including that of Lt. Col. Sir Thomas Moore, a British Conservative member of Parliament. In parliamentary debate, Sir Thomas said that he had "the impression, not being an economist, that currency had to be tied to or based on something; whether it was gold, or marbles, or shrimps, did not seem to matter very much, except that as marbles are easy to make, and shrimps are easy to catch, gold for many reasons possessed a more stable quality." For the soundest doctrine expressed in the fewest words, Sir Thomas was hard to beat.

Mr. Steil shines in distinguishing between one kind of gold-based monetary system and another -- and between gold money of any kind and the pure paper variety in circulation today. The true-blue, or classical, gold standard expired in 1914 after a century of honorable service. It was associated with long-term price stability, peace and prosperity. The gold-exchange standard -- a third-rate variant on the original -- came along in the 1920s and 1930s. It was associated with price instability, war and depression.

In elegance and simplicity, the two systems were day and night. The classical gold standard was more-or-less self-regulating, whereas the gold-exchange standard was heavily managed. The classical gold standard featured the timely settlement of international debts, while the gold-exchange standard tended to institutionalize imbalances between debtor and creditor nations. The classical gold standard afforded anyone the right to exchange gold for bank notes or vice versa, whereas the gold-exchange standard restricted the right of convertibility to governments.

Would you not join me in declaring gold standard 1.0 the hands-down winner? White and Keynes wanted nothing to do with it. They didn't want a system that imposed fiscal and monetary constraints on national governments. They rather insisted on the absence of constraints, the better, they said, to allow sovereign states the means to resist depression and unemployment. The gold-exchange standard, or a variation on that theme, was the one for them.

So it was decided at Bretton Woods that the dollar would be convertible into gold. Other currencies would be convertible into the dollar. Depression- and wartime-era restrictions on trade would be torn down, if not today then tomorrow. The World Bank and the International Monetary Fund would implement the grand design.

At least, those were the bullet points. The dollar was indeed made convertible into gold at $35 an ounce, but only governments could make the conversion -- if they had the temerity to ask. Exchange rates were fixed, not floating, but nations could devalue by 10% at will -- and by another 10% if they really felt they had to. The IMF would furnish credit on a purely nonjudgmental basis to governments that found themselves short of liquidity; it was Keynes's position that there should be no discrimination on the basis of credit-worthiness or lack thereof. While goods would move as freely as possible from one trading partner to the other, investment capital would be tightly controlled. Henry Morgenthau, Roosevelt's Treasury secretary, vowed to "drive . . . the usurious money lenders from the temple of international finance." So saying, he distilled the statist spirit of the proceedings.

Though White and Keynes fought over many things, they agreed that the experts -- themselves, notably -- knew best. Governments had come of age, Keynes contended. And as they had become "trustworthy," so they should direct and control the financial life of nations. As for central banking, pronounced the famous economist from King's College, Cambridge, it should "be regarded as a kind of beneficent technique of scientific control such as electricity or other branches of science are." Not even Fed Chairman Ben Bernanke could utter those words today without blushing.

Though Keynes lavishly praised "The Road to Serfdom" (1944), Friedrich Hayek's compelling brief against the then-ruling tenets of state socialism, Keynes had his own, non-Hayekian agenda. At the top of Keynes's to-do list was somehow to restore Britain to membership in the family of solvent nations. As for White, Mr. Steil relates, his ambition was to make the U.S. dollar the world's top monetary brand, and in this he succeeded, though not in the way he intended.

"There is no likelihood," White assured the House Banking Committee in 1945, "that . . . the United States will, at any time, be faced with the difficulty of buying and selling gold at a fixed price freely." But the impossible proceeded to happen. By 1964 -- the year that the James Bond film "Goldfinger" hit the silver screen -- foreign governments owned dollars worth more than the American monetary gold hoard. It was only a matter of time before overseas dollar-holders presented an unmanageable volume of paper for redemption into gold at the official $35-per-ounce rate.

Richard M. Nixon closed the Bretton Woods monetary era when, in a televised address to the nation on the evening of Aug. 15, 1971, he announced that the Treasury would stop paying out gold. In other words, the dollar would henceforth be as good as paper. Here is one political promise that the government has faithfully kept. The World Bank and the IMF are still in business -- bureaucracies are immortal -- but, apart from them, the long-lingering legacy of Bretton Woods is the dollar's privileged position in the world.

It's a privilege that this country could easily do without. Rare among nations, America pays its overseas debts in money that it alone may lawfully print. Naturally, being human, we Americans have printed to excess. Not since 1975 has the United States exported more goods and services than it has imported. There is no institutional check to square up accounts. We buy Chinese merchandise with dollars. The Chinese, in turn, invest those dollars in U.S. government securities (the better to suppress the value of the Chinese currency). It's as if the money never left the 50 states. In possession of the "reserve currency" franchise -- White's dream fulfilled -- America has become the world's leading debtor nation. At Bretton Woods, it was the world's top creditor.

According to Mr. Steil, the recondite Bretton Woods debates failed to engage the American public as a political issue. If so, it was no fault of Henry Hazlitt's. An editorial writer for the New York Times, Hazlitt directed persistent, withering fire against White's and Keynes's brainchild. (His collected editorials, titled "From Bretton Woods to World Inflation," were published in 1984.) The conference had it all wrong, Hazlitt thundered in the Times. The IMF would subsidize unsound policies. What was wanted were sound ones.

"The broad principles should not be difficult to formulate," the readers of the Times were reminded on the eve of the gathering in New Hampshire. Governments should balance their budgets, forswear 1930s-style impediments to free trade (quotas, exchange restrictions) and refrain from "currency and credit inflation." And the currency itself? It should be "redeemable in something that is itself fixed and definite: for all practical purposes this means a return to the historic gold standard."

"These requirements form a unit," Hazlitt the editorialist went on. "If one of them is violated it will be difficult, if not impossible, to fulfill the others. Thus if a nation's budget is chronically unbalanced it is practically compelled to resort to borrowing through currency or credit inflation to make up the difference." As presented, Hazlitt warned, the Bretton Woods plan would never last.

White was a Harvard Ph.D. Keynes was, at least according to Mr. Steil, "the most innovative and iconoclastic economist of his age, if not of all time." Hazlitt was no trained economist at all. But it was he, not the two acclaimed experts, who turned out to be right.

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