



The Big Read **Global Economy**

Martin Wolf on Bretton Woods at 75: global co-operation under threat

Economic governance system established in 1944 is being undermined by protectionism and nationalism

Martin Wolf in London YESTERDAY

“We have come to recognise that the wisest and most effective way to protect our national interests is through international co-operation — that is to say, through united effort for the attainment of common goals.”

US Treasury secretary Henry Morgenthau Jr, [closing address at Bretton Woods Conference](#), July 22, 1944

“We must protect our borders from the ravages of other countries making our products, stealing our companies and destroying our jobs. Protection will lead to great prosperity and strength.”

Donald Trump, [inaugural presidential address](#), January 20 2017

The conference at [Bretton Woods](#) in New Hampshire that underpinned much of today’s global economic order took place three-quarters of a century ago, between July 1 and 22 1944. The second world war was not yet won. Yet already the western powers — the US, above all — were thinking about how to organise things differently for the better world that had to lie ahead.



The opening day of the Bretton Woods conference in 1944

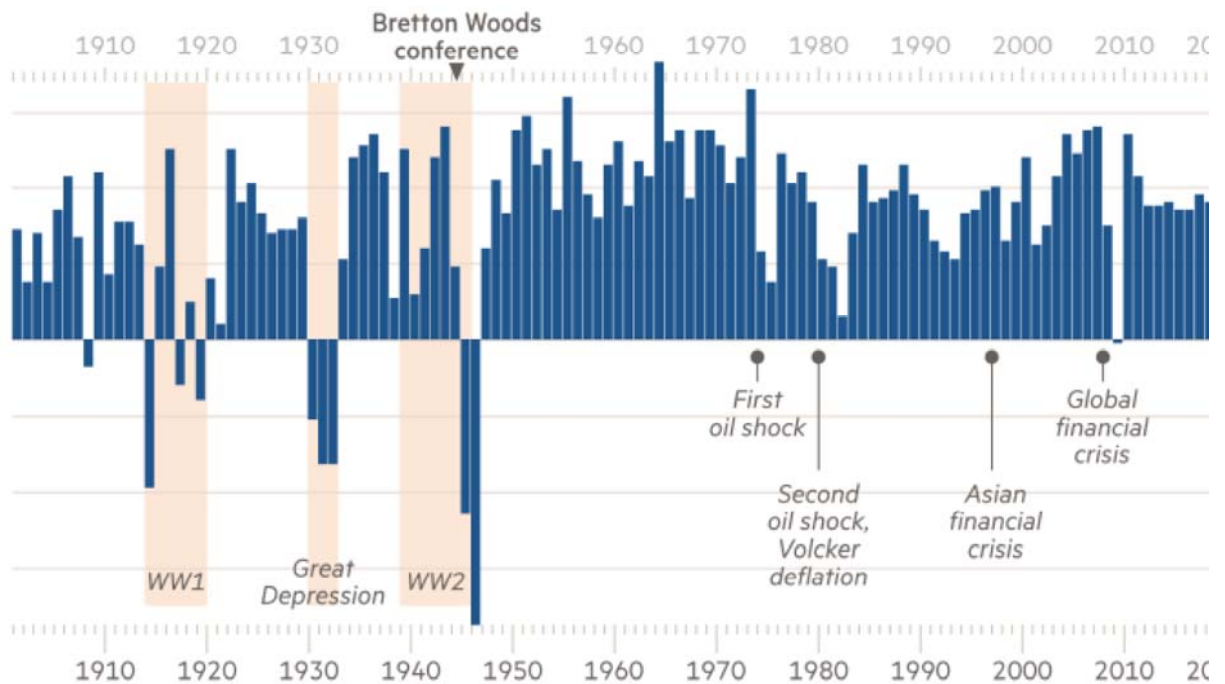
The world has changed enormously since then. Today, the spirit that animated the conference [is embattled](#). Yet it remains as relevant as it was in 1944. This anniversary is more than an arbitrary moment: it is an occasion for reflection, on what has gone right, what has gone wrong and what needs to happen if the spirit of Bretton Woods is to shape the world in the decades ahead or fail, as the [League of Nations](#) did between the two world wars.

An impressive collection of 50 essays — [Revitalising the Spirit of Bretton Woods](#) organised by the Washington-based [Bretton Woods Committee](#) — explores the formidable challenges ahead. As Gail Kelly, former chief executive of Westpac, says: “In 2019, Bretton Woods reaches its 75th anniversary . . . [T]here is indeed a lot to celebrate. But growing and strident nationalism, coupled with ardent protectionism, are making the challenge much harder.”

Paul Volcker, former chairman of the US Federal Reserve, [encapsulates the spirit of Bretton Woods](#): “The belief in a common interest in international co-operation, the importance of certain basic rules of good behaviour with respect to exchange rates, and the need for development among the multitude of ‘emerging’ nations.” With the [General Agreement on Tariffs and Trade](#), which went into effect as a provisional agreement in 1948, this idea of “certain basic rules of good behaviour” also covered trade.

The post-Bretton Woods world economy has been much less unstable

Growth in global GDP (in purchasing power parity, %)



Sources: Angus Maddison; IMF; FT research
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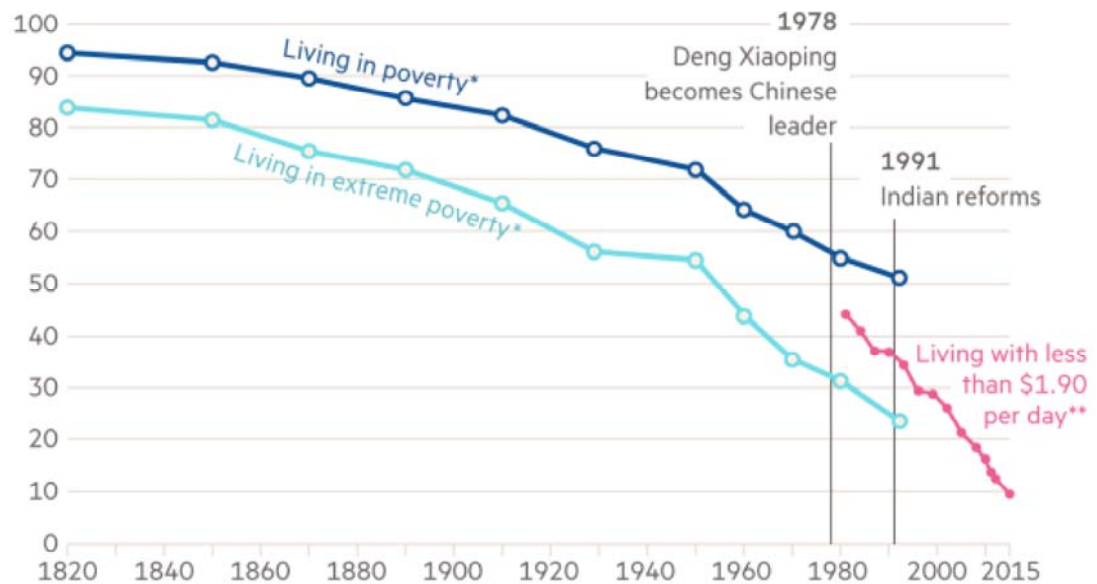
In economic policy, Bretton Woods means a commitment to co-operation, contractual obligations among nations and effective international institutions — the International Monetary Fund, the World Bank group and the [World Trade Organization](#).

Today, there is far more to institutionalised economic co-operation than these three institutions. The regional development banks, created on the model of the World Bank, and, more recently, the [Asian Infrastructure Investment Bank](#) and the [New Development Bank](#), sponsored by China, also play an important role.

Two informal groups of countries have also been influential: [the G7](#), which includes the seven largest high-income economies; and since 2008 [the G20](#), which includes the leading emerging economies and the EU.

The proportion of people in extreme poverty has fallen dramatically

Share of world population (%)



* Living with less than \$2 per day (poverty) or \$1 per day (extreme poverty)

** World Bank measure of poverty introduced in 2015

Sources: Bourguignon and Morrisson; World Bank; ourworldindata.org

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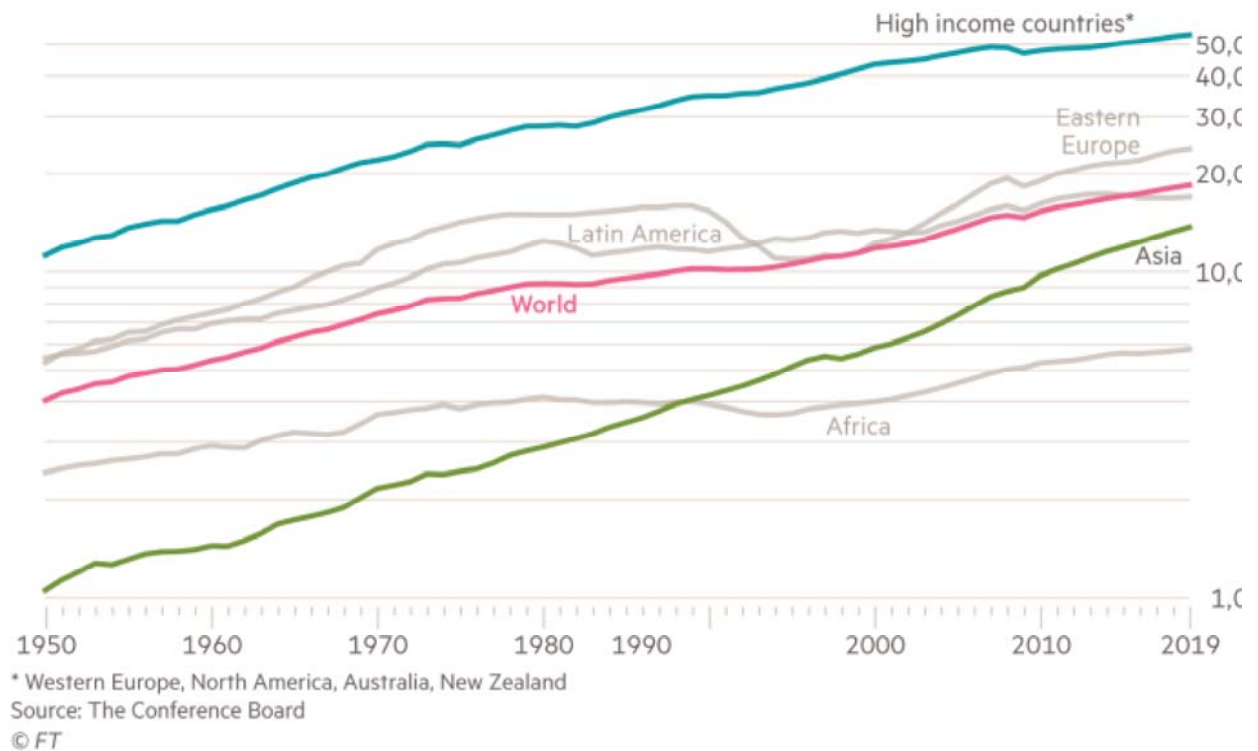
If we judge the era that followed Bretton Woods by economic performance, we have to conclude it has been a triumph. In their chapter, Nicholas Stern of the London School of Economics and Amar Bhattacharya of the Brookings Institution note that “overall, world income per capita has grown by a factor of four since 1950 as population has roughly trebled”. Between 1950 and 2017 the volume of world trade increased 39 times.

The share of the world’s population living on less than \$2 a day (at 2011 purchasing power parity levels) declined from about 75 per cent in 1950 to 10 per cent in 2015. Global inequality has also fallen significantly during the past few decades, largely because of the rapid rise of the large Asian emerging economies, especially China and India. Moreover, the world economy was also far more stable than it had been in the first half of the 20th century.

These advances did not occur because everything went smoothly. The regime of fixed, but adjustable, exchange rates collapsed in 1971, when the Nixon administration broke the dollar’s link to gold. Inflation then exploded upwards in the 1970s, to be tamed, at substantial cost, in the 1980s. Financial liberalisation delivered waves of banking and debt shocks, which culminated in the global and eurozone crises of 2007-13.

Living standards have risen far faster in Asia than in any other region

Average GDP per head (at purchasing power parity, \$ at constant 2018 prices, log scale)



Bouts of protectionism erupted, not least in the early 1980s in the US, in response to the strong dollar and the success of Japan. A trading system founded on the principle of non-discrimination also morphed into one with a host of preferential (that is, discriminatory) trading agreements.

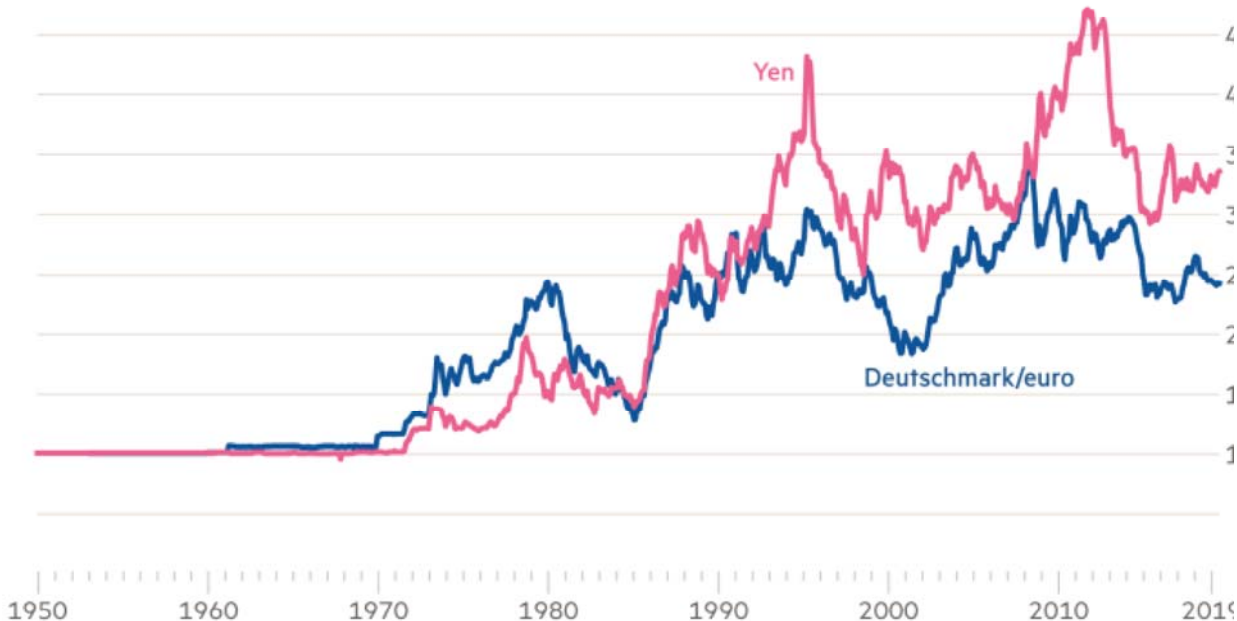
Overall, the Bretton Woods ideal of structured co-operation worked extraordinarily well. But new challenges have emerged. Perhaps the most important is the shift away from western and, above all, US dominance, with the rise to superpower status of China. On some measures, China already has the biggest economy in the world.

Also significant has been the rise of nationalism and protectionism and the consequent threat of fragmentation not just globally, but also within the west. Mr Trump's idea of "America First" and [his passionate belief in protectionism](#) are a fundamental repudiation of the animating spirit and institutional structure of the order the US created after the second world war.

The emergence of this very different spirit is, in turn, a consequence of economic changes that have undermined trust both in the idea of an open world economy and in the people and institutions that manage it. Important causal factors in high-income countries have been deindustrialisation, rising inequality, the slowdown in productivity growth and the shock of the unexpected financial crises. Today, unlike 40 years ago, it is the citizens of the high-income countries, not of the emerging world, who are most suspicious of global economic integration.

Big fluctuations followed the end of the era of fixed exchange rates

Currencies against the dollar (\$ per currency, rebased 1950 = 100)



Source: IMF
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Deglobalisation has begun. Catherine Mann, former chief economist of the OECD, points to declines in the trade intensity of growth and the unravelling of global value chains since the financial crisis. This, she argues, may also be one reason for slowing productivity growth. Cross-border financial flows also peaked in 2007.

Another shift is growing pressures on the environment, especially climate change. The world, it is now argued, has moved from the Holocene to the Anthropocene: a planet largely shaped, both for good and ill, by human activity.

To this must be added technological change. More recently, these are undermining the comparative advantage of developing countries in labour-intensive manufacturing. They are threatening large-scale disruption to patterns of employment. They are creating new cross-border flows, notably of data. They are transforming payment systems and are likely to have even bigger effects on monetary systems.



A wildfire near Athens in July 2018. Global warming has become a pressing issue for multilateral organisations © AFP

So how is a co-operative global economic order to be sustained? This question can be addressed narrowly, in terms of institutional purpose and architecture, and more broadly, in terms of international relations.

The focus of the essays is on the former. It includes the management of monetary and financial systems, the future of development policy and the prospects for the WTO and world trade, which were all part of the debates at and around Bretton Woods. It includes newer areas for co-operation, such as corruption, climate change, fragile states, migration and technology.

One traditional issue is the reliance on the US dollar in the global monetary system. This was unresolved at Bretton Woods, when John Maynard Keynes proposed a global currency. In this volume, Jean-Claude Trichet, former president of the European Central Bank, argues that a supranational currency remains impossible. But a bigger role for SDR (special drawing rights — a reserve asset created within the IMF) is not. Managing the global monetary system as China's renminbi becomes more important will be a further challenge.

Inflation was brought back under control after the turbulent 1970s

Inflation in developed countries (annual % change)



Source: OECD
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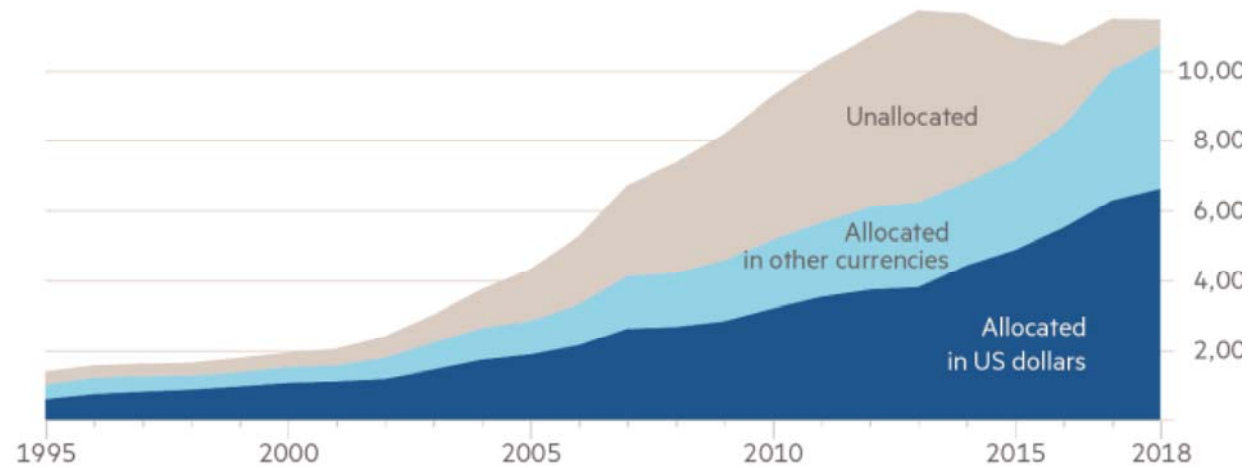
Another well-known issue is financial stability. On this, Mark Carney, governor of the Bank of England and former chair of the Financial Stability Board, is boldly optimistic: “The radical programme of G20 reforms has made the global financial system safer, simpler and fairer.” Whether it has made it sufficiently safer will only be known in time.

A depressingly familiar issue is the future of the trading system. Global liberalisation has halted. The US has not only moved in a decisively protectionist direction, but has contravened the letter and spirit of the WTO. It has also sought to neuter the dispute settlement system of the [WTO by rendering it inoperative](#).

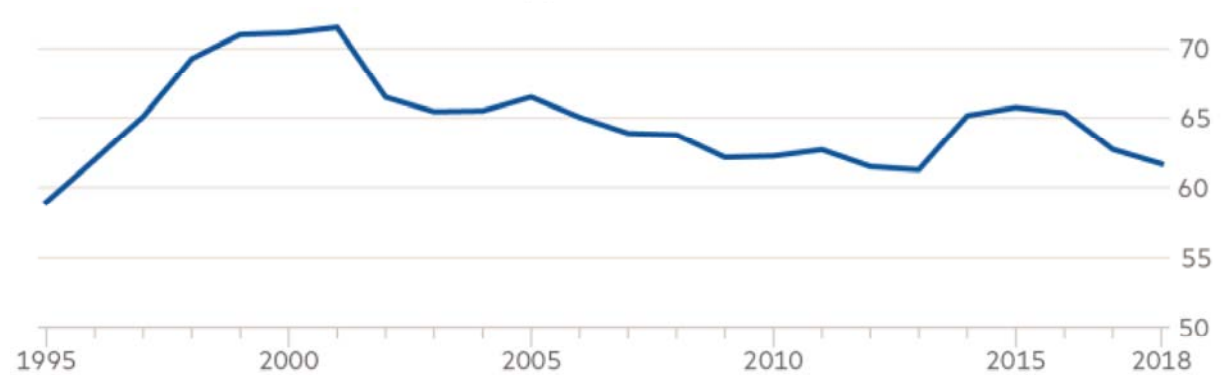
On development, Sri Mulyani Indrawati, Indonesian finance minister and former chief operating officer at the World Bank, emphasises the need for vast investment if today’s ambitious [“sustainable development goals”](#) are to be met. Direct funding by multilateral development banks, including the new Chinese-led ones, will be totally inadequate. Funding will have to come largely from the private sector.

The huge rise in reserves in the 2000s illustrates the perceived inadequacy of IMF resources

Currency composition of world foreign exchange reserves (\$bn)



Share of US dollars in allocated reserves (%)



Source: IMF
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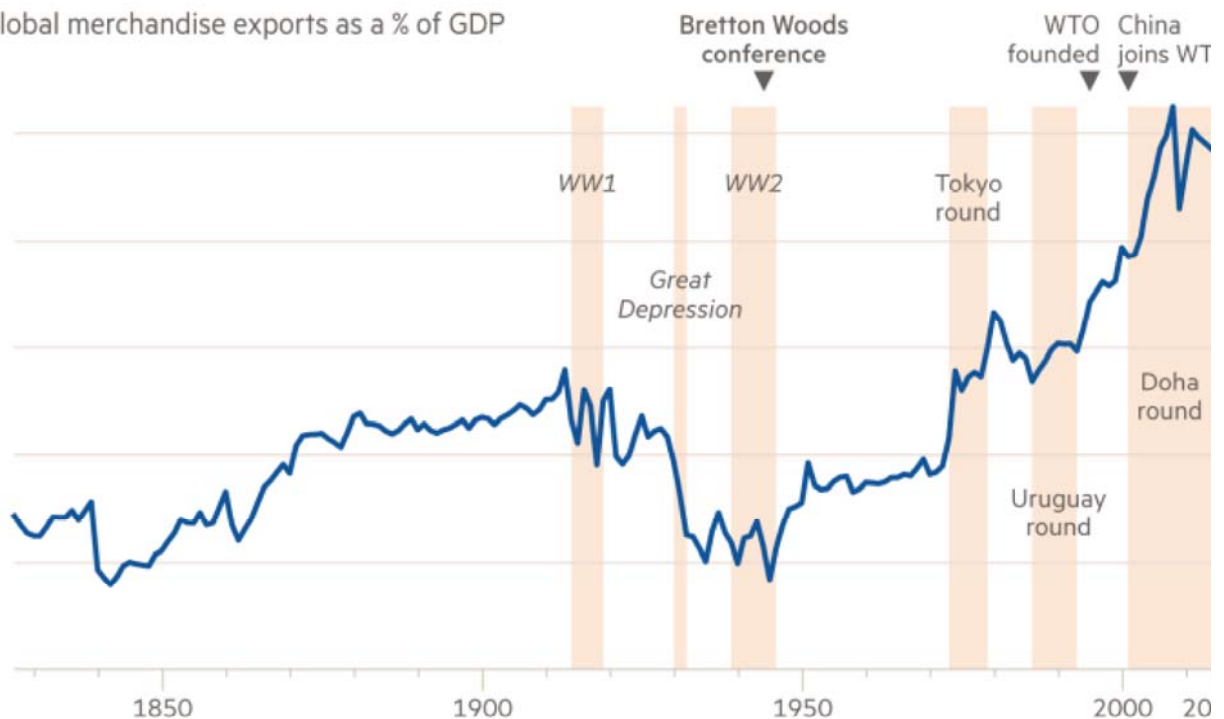
David Miliband, head of the International Rescue Committee and former UK foreign secretary, stresses that “more than 40 per cent of the extremely poor now live in conflict-affected or fragile states”. This is also the origin of much of the global migration pressure. Thus, if extreme poverty and the flood of refugees are to be eliminated, such conflicts need to be addressed. So, too, he argues, does the pressure on the relatively poor countries that are now host to 84 per cent of the world’s refugees.

Climate change is making such problems worse. Yet selfish high-income countries, notably the US, have apparently decided not to tackle this challenge. Sanctions on such behaviour may have to be considered.

Another important challenge is corruption, discussed by Frank Vogl, co-founder of Transparency International, and William Rhodes, former senior vice chairman at Citigroup. They write that “IMF officials privately concede that they need to do more by explicitly raising issues of illicit finance with the governments of major western developed economies, whose capital markets provide safe investment havens for so much of the illicit cash.” Yes, that includes, above all, American and British capital markets.

The world's openness to trade reached record levels before the financial crisis

Global merchandise exports as a % of GDP



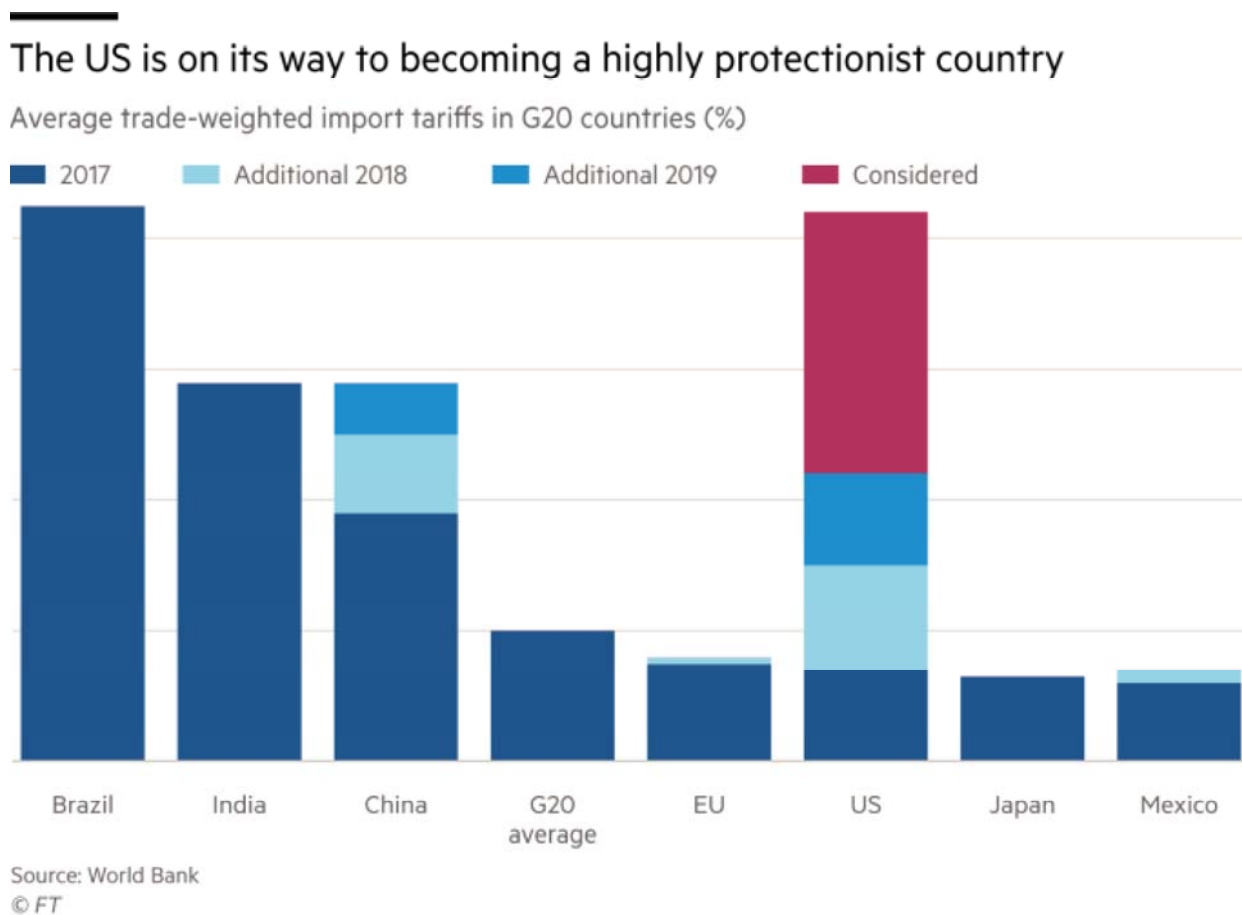
Sources: Fouquin and Hugot, “Two Centuries of Bilateral Trade and Gravity Data: 1827-2014” (CEPII 2016); ourworldindata.org

These perfectly proper questions about how institutions are to be reformed and new challenges to be tackled, including the need to reflect changes in global power in institutional governance, are, to a degree, secondary. The bigger question is whether the necessary level of co-operation is to be sustained at all.

Today’s economic challenges are met by a resurgent nationalism. Yet countries are not islands. If anything, global co-operation is more important today than 75 years ago. But it has also become more difficult.

The “realist” school will tell us that co-operation is a pipe dream: international relations are always about the brutal politics of power. But is a system “realistic” if it leads to disastrous results for everybody? Only if conflict is the only imaginable system. Now that the world does not have a dominant superpower, the old hierarchical US-led system is no longer feasible. But some sort of co-operative system is still essential.

Keyu Jin of the London School of Economics, one of only two Chinese contributors, lays out a novel way of thinking about this challenge. She argues that economic networks may supersede relations among nations and render traditional notions of hegemony redundant. China, she suggests, may end up not as another hegemon but as a “global network leader”.



The big point Prof Jin makes is a central one: how do we create enough order and co-operation to sustain our complex, interdependent and environmentally stressed world, without a hegemon most countries want to follow? It can only be through networks of networks, set within global commitments.

Bretton Woods shaped the post-second world war era not so much because of the specific agreements reached, but because of the commitment to institutionalised co-operation it embodied. This commitment has remained vital, through the twists and turns of the subsequent 75 years, and remains as important as ever.

Institutions must indeed develop. New challenges must be met. Yet if the world is unable to sustain and develop the underlying commitment to co-operation, global progress may not be sustained and the challenges we confront may not be met.

Morgenthau was correct. Mr Trump is wrong. It is as simple — and as difficult — as that.

The unit in the chart on foreign exchange reserves has been corrected to \$bn

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