Shaping the Bretton Woods Monetary System and the IMF; 1944-61[1]

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Abstract

After the global financial crisis in 2008, we are facing the parallel situation to the wartime; call for New Bretton Woods and the expectation for International Monetary Fund (IMF, the Fund). In this paper, I will review the Bretton Woods monetary system and the role of the IMF, thereby prospect the future. So far, the IMF was described as a useless agent for its principal the U.S. in the Bretton Woods Era and hence its role has been understudied. Thus, I will challenge this ordinary view by examining the works of the Fund's staffs headed by the Managing Directors. The period I research is from 1944 to 1961, so called pre convertible period. Based on the archival records, various facts will be presented regarding the policy making efforts made by the Fund's staffs. Through the rethinking the role of the IMF, I will also shed new light on the question what the Bretton Woods monetary system was.

Key Words; Bretton Woods monetary system, IMF, balance of payments adjustment, Article XIV consultations, convertibility, exchange liberalization

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1 Introduction

1.1 Call for New Bretton Woods

International financial turbulences which had repeatedly occurred all over the world since 1980s (Laeven and Valencia 2008, pp.50-56) culminated with the global financial crisis in 2008. In this tipping point, Bretton Woods attracts quite some attention again.

So far, many international political scientists have strongly supported the ideal of the Bretton Woods. They attribute the repeated financial crises to financial globalization and hence appreciate “embedded liberalism”; the idea of restrictions against short term capital, which secured full employment and multilateral trade (Ruggie 1982; Helleiner 1994; Strange 1998). Furthermore, Dani Rodrik, by presenting the idea of political trilemma of the world economy (nation state, democratic politics and hyper globalization; globalization paradox), praised the “Bretton woods compromise” which secured nation state and democratic politics by controlling globalization (Rodrik 2012, pp.200-205.). For them, Bretton Woods has been a goal where to return again.

On the other hand, in the field of international monetary history, global crises reignite a traditional debate thereby shed light on Bretton Woods. We have everlasting and controversial history over unsustainability of key currency system and instability of multipolar system (Brown 1940; Triffin 1960; Despres et al. 1966; Mundell 1969; Kindleberger 1973; McKinnon 1996; Eichengreen 2011). Beginning with the debate between Michael Dooley and Barry Eichengreen over sustainability of global imbalance (Bretton Woods Ⅱ) (Dooley 2003; Eichengreen 2007), the U.S. triggered crisis enhanced a concern for the flaw of the dollar system (key currency system) which has barely survived since Bretton Woods.

Thus, Bretton Woods is recognized as an origin of postwar international financial system. In some cases, the Bretton Woods conference still a symbol of miraculous international cooperation in our history. In fact, some works again shed review the process of shaping the Bretton Woods (Steil 2013; Conway 2015).

Along with this growing interests in Bretton Woods, global financial crisis let the International Monetary Fund (IMF, the Fund) take on the stage of international financial cooperation again. Though the IMF had fallen into stagnation since the failure of management of Asian crisis, the global crisis promotes the Fund's reform against future crises; enlargement of the Fund, quota increase, establishment of various new facilities, streamlining the conditionality and enforcement of the surveillance. Thus, this parallel situation which New Bretton Woods is called for and IMF mandate is expanding leads us to the questions; What is the Bretton Woods monetary system? What role did the Fund play in the Bretton Woods era?

1.2 Exploring in the history; the Bretton Woods and the IMF

In July 1944, representatives of 44 governments signed Bretton Woods Agreement. Despite the miraculous success of this wartime collaboration, Richard Gardner's traditional study (Gardner 1956) and Harold James' comprehensive work (James 1996) described that the Bretton Woods was too idealistic to solve the post war financial problems. Major economies were suffered from serious dollar shortage therefore strictly restricted exchange transactions while the Bretton Woods organizations weren't equipped enough to solve these problems. After 1945, the U.S. government changed its attitude substantially and began to seek a way of managing international economy outside the Bretton Woods (James 1996, p.62.).

Instead of the Bretton Woods organizations, postwar reconstruction and return to convertibility were gradually attained by Marshall Plan and intra-European cooperation led by the Organization for European Economic Cooperation (OEEC) and the European Payments Union (EPU) (Bordo 1993, pp.41-43.). Thus, the 1950s was the period when major countries realized exchange rates stability and exchange liberalization; in other words, the period when dollar gap disappeared. In this period, the Fund wasn't a useful *agent* for its *principal* the U.S.

Despite the bitter appraisal, understudied issues seem to remain. It is the role that the Fund's staff division played. While the Executive Board where the major members have strong voting power has been a de fact decision making body, the Fund has numerous bureaucrats headed by the Managing Director (Fig.1.1). Though most senior positions were occupied by the staffs from major countries especially the U.S. (Table1.1), they weren't always subordinate to their countries' national interests.

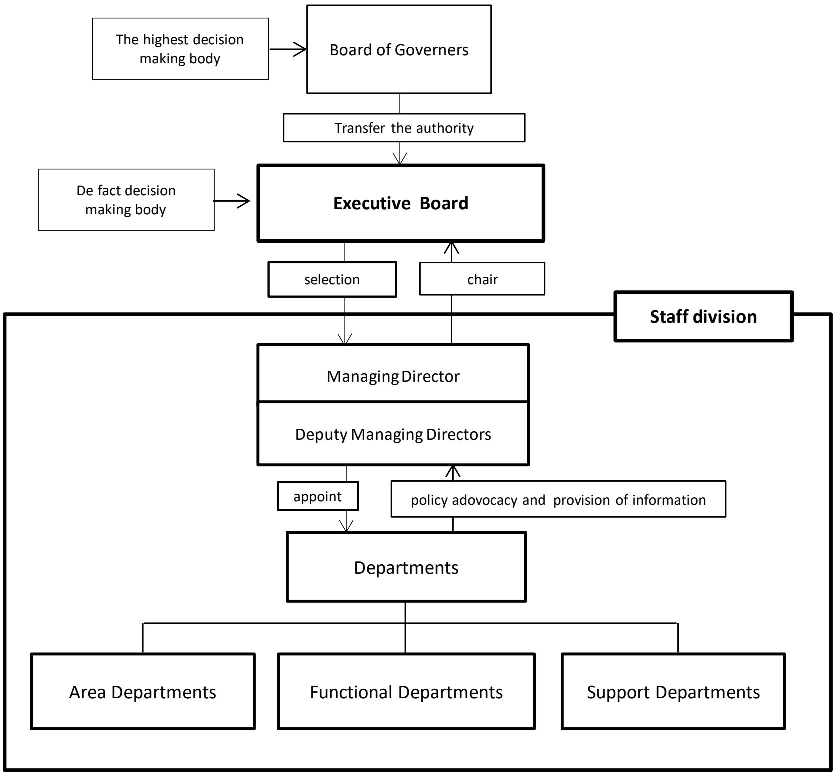

Fig.1.1 The structure of the Fund's decision making

Source: Author.

Table 1.1 Nationality and salary of the Fund's staff (as of the end of April 1947)

		10,000 USD～	7,000～ 10,000USD	4,000～ 7,000USD	～4,000USD
The United States	224	3	17	31	173
Europe	42	3	9	15	15
Canada	30	1	2	2	25
The United Kingdom	23	1	5	3	14
Latin America	20	–	4	4	12
Far East	11	–	4	3	4
Middle East	4	–	1	2	1
South Africa	1	–	1	–	–
Total	355	8	43	60	244

Source: IMF 1947, p.51.

As Jeffrey Chwieroth argued, Principal Agent theory solely couldn't explain the Fund's behavior. The change of the idea and behavior of its staffs, so called "organizational change from within" should be examined as well (Chwieroth 2009, pp.8-16.).

In fact, the Fund's history shows that the practice of the Fund's policy was evolved in the 1950s by staffs (Horsefield and De Vries 1969). In the early 1950s, two Managing Directors, Camille Gutt and Ivor Rooth, institutionalized the Fund's basic lending practice, which laid the foundation for the conditionality. Moreover, it was in the 1950s when the Fund's BOP adjustment theories, Absorption Approach and Monetary Approach, were developed by the staffs of Research Department (De Vries 1987, pp.19-30.). Especially, Monetary Approach devised by Jacques Polak later constituted the core of "the Fund's financial programing" (Polak 1998).

Then, how should we explain these contradictory events in the early period of Bretton Woods—"the Fund in stagnant" and "the Fund's organizational development"? What was the missing link connecting them? In this paper, I will shed new light on the international financial cooperation in the transitional period of the Bretton Woods by reviewing the Fund's operation. In particular, the policy making by the Fund's staff will be examined. The methodology of this study is mainly narrative one based on the archival records from IMF Archives including the Fund's publication.

The structure and contents of this paper are arranged chronologically; Chapter 2 covers the Fund's history in its infancy; 1944-52. In this period, the idea of Bretton Woods retreated and instead international cooperation developed in line with key currency approach. I will discover how the Fund's staff overcome this uncomfortable situation. The analysis will show the reason why the Fund's organizational evolution occurred in this stagnant period.

Chapter 3 and Chapter 4 cover pre convertible period; 1952-57. In this period, the Fund's staff began working on members' current account convertibility through the Article XIV consultations. The obstacle for convertibility was dollar gap. Therefore, the Fund's policy changed along with the world payments situation. I closely examined the policy making effort by the staffs, focusing on the relationship between the Fund and the United Kingdom which possessed key position in making convertible world.

Chapter 5 covers the period till the end of the transitional period; 1958-61. Major western economy finally brought dollar shortage under control and returned to convertibility at the end of 1958 thereafter transited to the Article VIII status in February 1961. It was paradoxical however that solving the dollar gap and current account convertibility was a prelude to the gold and dollar crisis. In chapter 5, it will be reviewed how the Fund's policy evolved against the crisis.

2 Creation of the Fund's Initial Policies; 1944-52

2.1 International Cooperation outside the Bretton Woods

In July 1944, at the International Monetary and Financial Conference held in Bretton Woods, representatives of 44 governments signed the Fund's Articles of Agreement and agreed on the establishment of multilateralism. It is true that this international monetary plan was an outcome of the "battle" between the Keynes plan and the White plan, but both of them were based on the common perception that the tragedies in the 1930s must never be repeated.

First, both plans were designed to restore the system of exchange rate stability and currency convertibility, reflecting the view that monetary disturbances had brought about the destruction of the international financial system and thereby the shrinkage of world trade. The scope of convertibility was, however, limited to the balance on current account, since the movement of short-term capital was thought to be destructive.

Secondly, the plans designed a monetary system that facilitated countries' achievement of full employment through "Keynesian fine tuning" and balance of payments equilibrium, and thereby expanded world trade. The real threat to the postwar world economy was assumed to be not severe inflation but deflationary pressure in the U.S., an outstanding creditor, and its international transmission.

Thirdly, to achieve these objectives, an international body was to be founded. The Bretton Woods Agreement was highly based on the economic idea of New Dealers. As Henry Morgenthau Jr., secretary of treasury, argued "drive the usurious money lenders from temple of international finance," creation of an international public body, IMF, was conceived (Gardner 1956, p.76.). The Fund was supposed to encourage its members to restore current account convertibility, giving them short-term finance that facilitated a conflict caused by the concurrent pursuit of full employment and balance of payments equilibrium.

On the other hand, Bretton Woods had to go through with another battle in its ratification process. In fact, Bretton Woods approach itself hardly reached consensus and was attacked both in the United States and the United Kingdom. In the U.S., Republicans headed by Robert Taft argued that the Bretton Woods wouldn't contribute to the U.S. interests and hence wouldn't be worth spending with. The government finally conciliated the opponents in the congress by setting up National Advisory Council on International Monetary and Financial Problem (NAC) and had the U.S. representatives for Bretton Woods organizations obey the committee.

Moreover, professor John Williams of Harvard University argued that it was premature to adopt Bretton Woods before a solution to postwar disturbances was in sight and proposed a "key currency plan" as a constructive alternative way to multilateralism. This plan criticized the ideal of Bretton Woods, noting that close collaboration on solutions to transitional problems between the U.S. and the U.K. was needed prior to multinational cooperation on the Fund. In the U.K., Bretton Woods was also not thought to be useful for bringing the urgent problems, the dollar shortage and accumulated sterling balance, under control.

In March 1947, the Fund began financial operation. Soon after that, however, it turned out that reconstruction was unavoidable before the Fund took the stage. After the declaration of the Truman Doctrine, the Cold War had broken out and the "Marshall speech" in June called for the U.S. government to help European recovery. Moreover, although sterling convertibility was restored in July as promised in the Anglo-American Loan agreement, a run on sterling crushed the trial, causing it to fail after just a month. The dollar gap was so serious that the severe inflation resulting from large reconstruction demand hit major countries, contrary to the assumption of the founders of the Fund, and world trade was taking place not on a multilateral basis but under numerous bilateral arrangements. However, the Fund wasn't equipped to cope with these disturbances. As a result, the U.S. government turned their policy from Bretton Woods approach to key currency approach.

In April 1948, Marshal Aid (European Recovery Program; ERP), began and inspired the European recovery. By contrast, the U.S. Director of the Fund made an "ERP Decision" that discouraged the ERP participants (European members of the Fund) from accessing the Fund's resources. The Fund's resources were too small to cover all the need for European recovery, which discredited the Fund with its European members.

Instead, the OEEC organized in response to Marshal Aid led to financial cooperation on establishing an intra-European multilateral payment scheme and, in September 1950, the EPU, which covered most of the non-dollar area, was established. Moreover, the OEEC took the initiative in intra-European trade liberalization, applying a "Code of Liberalization." Thus, the international cooperation developed outside the Fund. Regionalism and gradualism turned out to be practical approach to multilateralism. By early 1950s, the Fund's lending fell sharply (Fig. 2.1).

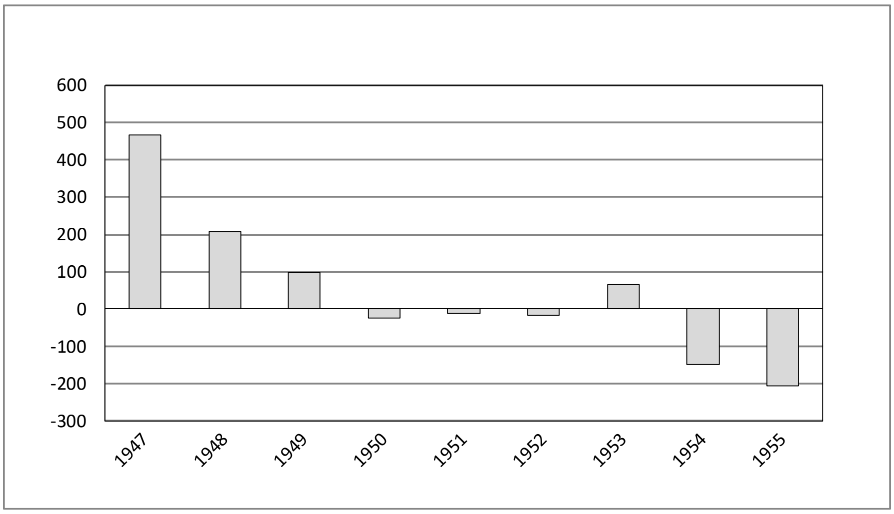

Fig 2.1 The declining of the Fund's net lending in its early period (in millions of US $)

Source: Horsefield and De Vries 1969. Vol.2, pp.460-467.

Nevertheless, it would be too shallow to conclude that the Fund put up with the disappointing situation of being a "Fund with no customer" through 1950s. How did the Fund's staff perceive the fact that progress on exchange liberalization which was to be the exclusive mandate of the Fund was led by the other institution? The conclusions will show that the Fund's staff was far from an idle spectator. According to some historical records, the staff, headed by the Managing Director, took the situation seriously as a process undermining the Fund's prestige.

For instance, at the Board on November, 1948,[2] Camille Gutt, the First Managing Director of the Fund, made a speech and showed keen interest in the development in Europe, saying "The Paris plan is much concerned with multilateralization; e.g., convertibility. Well, on a limited but nevertheless substantial scale, the Fund agreement is an attempt at convertibility. Therefore, nothing of what passes in Paris can leave us indifferent." Then, he advocated that the Fund should lead the OEEC, insisting "There is *one* international monetary policy-making body in the world, and *only one*: the Fund. It should therefore be associated with any movement, any organization having a connection with international monetary policy."

Moreover, Irving Friedman who was the Director of the Fund's Exchange Restrictions Department argued the Executive Boards that the Fund should play a greater role as follows; "Urgent consideration needs to be given to the problem of the significance of the new world situation for the achievement of the Fund's objectives with regard to multilateral trade and payments. Neglect to consider this aspect may prove costly to the member countries. [...] If member countries are ready to endorse steps towards greater multilateral trade, the Fund is in a position to perform a number of helpful activities. As an "<u>international umpire</u>," the Fund could undertake to conciliate difficulties arising between member countries on such controversial issues as what constitutes a reasonable level of reserve. In its role as an <u>international financial adviser</u>, the Fund could focus its research and analysis, as well as operations, upon acute current problems."[3]

Thus, as early as the early 1950s, the Fund's staffs began devising methods to lead members' exchange liberalization. What did prevent the members from exchange

[2] IMF Archives (hereafter IMFA), EBM48/382, European Payments Arrangement, November 12, 1948.
[3] IMFA, SM 50/522, Multilateralism versus Restrictionism in the New World Situation, August 4, 1950.

liberalization? How could they go way forward to convertibility? These were the issues to be studied so as to devise the Fund's economic policy.

2.2 Formulation of the Fund's Adjustment Policies

2.2.1 Publication of "Annual Report on Exchange Restrictions"

In March 1950, the Fund started to publish the "*Annual Report on Exchange Restrictions*." Article XIV, Section 4 set forth "Not later than 3 years after the date on which the Fund begins operations and in each year thereafter, the Fund shall report on the restrictions still in forth." This report, published based on this prescription, covered the exchange restrictions of all members and reported the policy the Fund should apply in the year.

In the first report, the staff pointed out dollar shortage as a main obstacle against exchange liberalization and attributed it to both residual inflationary pressure and a lack of effective international cooperation.[4] Some statistics show the dollar gap was still serious (Fig. 2.2) and the inflation was sever even in the OEEC region (Fig. 2.3).

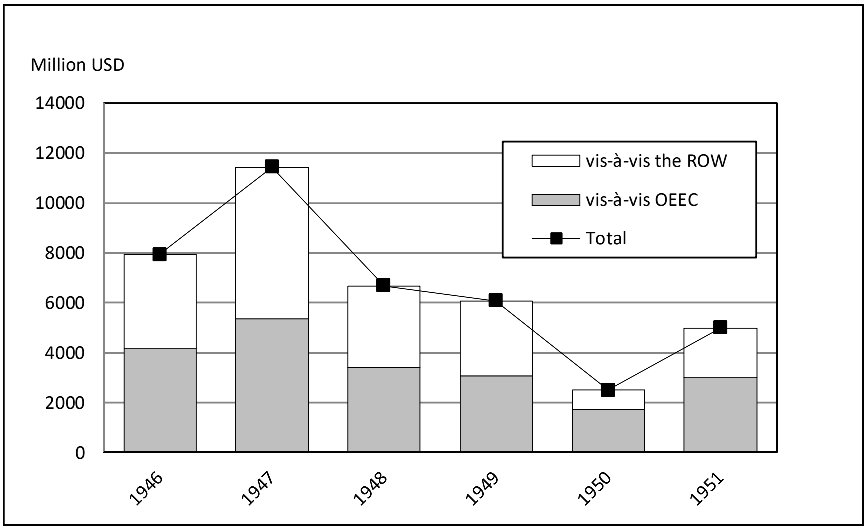

Fig. 2.2 The U.S. current account surplus in reconstruction period (in millions of US＄)

Source: IMF (1949-1951). *Balance of Payments Yearbook*, Vol.2-4. Donations and grants were excluded.

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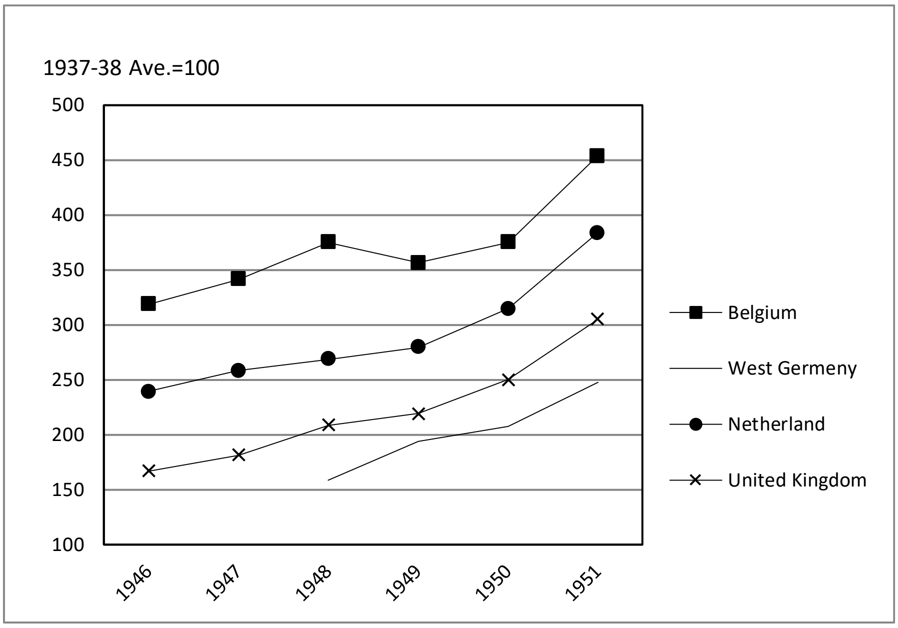
[4] IMFA, SM50/436, First Annual Report on Exchange Restrictions, February 6, 1950.



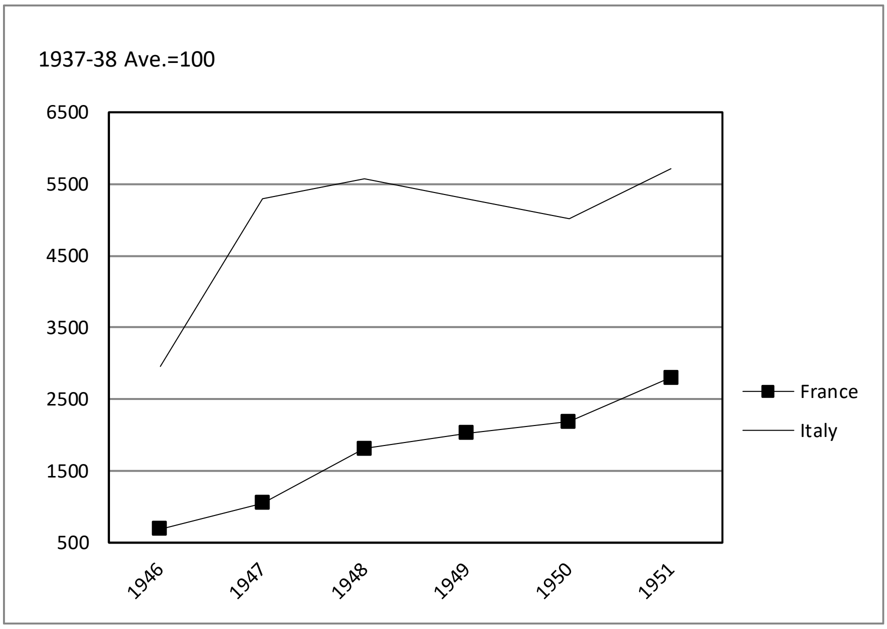


Fig. 2.3 Inflation in the OEEC countries in reconstruction period

Source: IMF 1951. *International Financial Statistics*, Vol.4, and OEEC 1954.

Then, the staff mentioned the efficacy of tightening policies against inflationary pressures and the significance of international cooperation to overcome the dollar shortage, noting that “Every country must observe restraints in its credit and fiscal policies if its par value is to remain realistic for any length of time [⋯] the Fund continues, therefore, to urge its member countries to practice the restraints in their domestic policies which are necessary to avoid inflation and its adverse effects on their payments position. [...] Some factors which have a bearing on the payments position of members are clearly of external origin, and no country can by itself control them."

In addition, the staff emphasized the importance of the Fund's leading role in resolving members' payments problems and in relaxing exchange restrictions, as follows; "In Article I of the Articles of Agreement, member countries have signified their intention to work together toward the multilateralization of international payments and the elimination of exchange restrictions which hamper world trade. They have established and recognized the Fund as the instrument for coordination and cooperation in the monetary field. [...] The Fund expects also to contribute to the progress toward the relaxation of restrictions by initiating, encouraging and coordinating appropriate concerted action among its members."

Thus, as early as 1950, the Fund's staff had already started to challenge the postwar disturbances in order to recover the Fund's prestige. The policy designed in the report was consequently different from the one that had been expected at the Bretton Woods conference; to facilitate a consistency both full employment and balance of payment equilibrium for its members. Instead, the staff began to pursue a policy which was "balance of payments-oriented," and therefore one of stringent.

2.2.2 Formulation of the Adjustment Theory—Absorption Approach

Then, what was the theoretical background of the policy that emphasized the effectiveness of tightening macroeconomic policy for balance of payments adjustment? The Articles of Agreement did not specify the role of macroeconomic policy. Instead, it assumed financial assistance from the Fund against short-term deficits and an adjustable peg system against fundamental disequilibrium. In fact, the approach was a brand-new one because under the gold standard a self-correcting mechanism was thought to adjust balance of payments and since 1930s the elasticity approach had prevailed (De Vries 1987, p.12..). It was absorption approach that shaped the Fund's policy at that time.

Under this approach, current account (CA) represents a gap between national product (Y) and national expenditure (absorption=consumption and investment: A)(CA=Y−A, ΔCA=ΔY-ΔA). Based on this theory, although improvements in current account are to be attained by increasing Y and/or restraining A, Y cannot be increased under conditions of full employment. The implication of the absorption approach would be concluded that to improve the current account government should restrain absorption, by applying a tightening policy (Alexander 1952).

The approach was formulated by the Fund's Research Department staff through their efforts to bring inflationary pressure under control, thereby correcting the balance of payments imbalance. At the outset of the Fund's operation, the staff headed by Edward Bernstein, the Director of the Department, recognized that the imbalance was brought about by inflation. By 1950, through missions, they had formulated the basic idea of the absorption approach; no matter how much par value may be depreciated, it would be impossible to correct the imbalance without curtailing excess national expenditure, which causes inflation (Black 1991, p.63.).

For instance, devaluation of an exchange rate caused declines in export prices, thereby increasing foreign demand for the goods of the devaluing country. The country needs to cover the increasing demand by expanding national product and/or restraining domestic demand for the goods. However, national product cannot be increased under conditions of full employment. Thus, under severe inflationary conditions, still more, devaluation does not recover a current account balance until national expenditure is restrained. The formulation of the absorption approach must be explained in the postwar historical context.

2.2.3 Formulating the Fund's lending practice

In addition to the theory, the method by which the Fund intervened in members' policymaking and adjusted their economies also was established in this period. Two managing directors, Gutt and Rooth, developed the Fund's lending policy. Article V prescribed the principle of transactions with the Fund, as follows; "The member desiring to purchase the currency represents that it is presently needed for making in that currency payments which are consistent with the provisions of this Agreement."

However, the criteria on use of the Fund's resources were still open to some interpretation and at the outset of the Fund's operation, the Directors had discussed the interpretation of Article V. The U.S. insisted that "present need" should be strictly scrutinized while the U.K. expected that members could freely access the Fund by only representing "present need." The prolonged disputes on "automaticity" consequently prevented members from accessing the Fund and resulted in the loss of the Fund's prestige.

It was Gutt who attempted to break the deadlock. At an informal session of the Board in November 1950,[5] Gutt advocated that the Fund should be an active and useful adviser to the members and insisted "the Fund's resources could be made available to give confidence to members to undertake practical programs of action designed to help achieve the purposes of the Fund Agreement." It is noteworthy that he described the "practical program" that members were expected to apply as follows: "The activities for which availability of the Fund's assistance would be regarded as appropriate would include the achievement of monetary stability, the adoption of realistic rates of exchange, the relaxation and removal of restrictions and discrimination, the simplification of multiple currency practices."

As his statement "Do you not think this would be a really constructive attitude of the Fund, would give the Fund a useful initiative, an activity, and restore some of the prestige it has—justly or unjustly—lost?" showed, his idea skillfully pursued not only overcoming the immobility of the Fund's resources but also realizing the purpose of the Fund—monetary stability and exchange liberalization for members.

In May 1951, the tenure of Gutt ended and the work on the formulation of the Fund's lending policy was taken over by Rooth, the second Managing Director. On arriving at the Fund, Rooth began to give shape to the general policy proposed by his predecessor and worked out the "Rooth plan" that was designed to make the Fund's resources circulate over the short term. To ensure the revolving character of the Fund, at a series of Board meetings in autumn Rooth proposed that (1) the interest rate schedule should be changed so as to lower the interest costs for short-term transactions

[5] IMFA, EBD51/828, Use of the Fund's Resources-Managing Director, February 5, 1951.

but graduate them more steeply for longer-term uses, (2) the repurchase period should generally be limited to within 3-5 years and (3) there should be a special term, giving an automaticity, for drawings within the gold tranche.[6] Through discussion, this "Rooth Plan" received the favorable support of the Directors and finally was approved. Thus, the two Managing Directors formulated the fund facility and enabled the Fund to be involved in the members' policy making process.

3 The Fund's Policy toward the Convertible World; 1952-54

3.1 The Fund's Support on Sterling Convertibility

3.1.1 Emphasis on International Cooperation

In March 1952, the Article XIV consultation started.[7] The Fund's staff launched into the members' exchange liberalization. As shown below, it was the U.K. and pound sterling that had the key position in this process.

In the "*Third Annual Report on Exchange Restrictions*" published in May, the staff emphasized the importance of international cooperation, noting that "The purpose of many of the restrictions employed is to cope with balance of payments difficulties of the country imposing them. Some of the difficulties, however, are the result of measures in important export markets. Limitations on imports by one country, through exchange or trade restrictions or other devices, restrict the earnings of other countries and consequently may result in the latter restricting their payments.

[6] IMFA, EBM51/710, Use of Fund Resources-Charges, October 26, 1951. IMFA, EBM51/717, Use of Fund Resources-Charges, November 19, 1951.

[7] Article XIV, Section4 prescribed "Five years after the date on which the Fund begins operations and each year thereafter, any member still retaining any restrictions inconsistent with Article VIII, Section 2, 3, and 4 shall consult the Fund as to their further retention." In the annual consultation, the Fund's mission reviewed the members' domestic economy, external balance and exchange restrictions on current transactions which were inconsistent with members' obligation prescribed in Article VIII, Section 2, 3, and 4; limitation to non-residential/residential convertibility and discriminatory restrictions. The mission pressed these members in Article XIV status to reduce restrictions as soon as the condition permits, thereby transit to Article VIII status.

Similarly, the inconvertibility of a country's earnings may lead it to discriminate in order to use its earnings in those areas where such use is possible and to avoid accumulation of inconvertible surpluses." (IMF 1952a, p.5). Thus, the first round of the XIV consultations, they inquired the members about their "prerequisites for exchange liberalization" so that the IMF could work on international cooperation well.

At the Consultation held in July 1952, the Fund's staff asked the U.K. representatives about the prerequisites for sterling convertibility. Arthur, M. Stamp, the U.K. representative, explained that though the existing gold and dollar reserves at the disposal of the U.K. were completely inadequate to meet any large conversion of sterling balances, the pressure to convert existing sterling balances could be restrained in a number of ways; (1) the U.K. might develop sufficient surpluses in its balance of payments by being provided dollars or by increasing its exports vis-à-vis the dollar area, or (2) the U.K. might draw on the Fund or raise loans in the U.S. or Canada and thereby acquire the dollars needed to ensure convertibility.[8] Table 3.1 compares the amount of the U.K. gold and dollar reserves and the sterling balance which was held by other than sterling bloc and dollar area. It shows that it was premature for the U.K. to return to convertibility without any financial support.

Table 3.1 Insufficiency of the U.K. gold and dollar reserves in the early 1950s

	1952	1953	1954
Gold and Dollar Reserves	1846	2518	2762
Sterling balance	1952	1892	2173

Source: IMF (1953-1956). *International Financial Statistics*, Vol.6-9.

After the 1952 Consultations, the U.K. requirements were applied as a pivot of the Fund's liberalization policy. At the Annual meeting held in September, Rooth proclaimed a policy that conformed to the U.K. "prerequisite." He indicated the key role the government of the U.S., a large creditor, should play and stated that "the deficit countries do not wish to become dependent on the bounty of the United States. I

[8] IMFA, CF C/U.K./420, Exchange Restrictions Consultations in 1952—Record of Third Meeting with U.K. Representative, July 2, 1952, pp.2-3.

believe that they can pay their way if they are able to expand their exports. The tariffs of the United States have been reduced in the past two decades, but for many goods they are still high." Then, he encouraged members to use the Fund's resources to make progress on their exchange liberalization, saying that "We are interested in having our members establish convertibility of their currencies. [...] a country can risk bold use of reserves which at times may be necessary with convertibility. After all, the Fund's resources are intended to help members to accept the risks and to gain the benefits of a convertible currency." (IMF 1952b, pp.14-18.).

Why did Rooth apply that policy? We can find a clue in the "*Fourth Annual Report on Exchange Restrictions*" issued in May 1953, as follows: "In many of the consultations, the Fund discussed with member countries the problems which they faced in making their currencies convertible. It recognized the fact that, for a number of them, the extent to which they could make progress depended [...] on what was done by their trading partners, with sterling occupying key position. The Fund, therefore, recorded its view that the interest of all member countries would be much advanced by the convertibility of sterling."(IMF 1953, pp.16-17.) This passage shows that most members mentioned sterling convertibility as their "prerequisites" at the First Consultations. Thus, for the Fund, sterling convertibility was the first step towards the early establishment of a multilateral payments system.

3.1.2 Controversies on Sterling Convertibility

On the other hand, the U.K. authority had conceived the plan for sterling convertibility named "ROBOT" by the end of 1951 and after autumn 1952, a "Collective Approach" was under contemplation. The dilemma of the authority was that the serious dollar shortage caused the need for exchange restrictions or suspension of convertibility, which hampered the position of sterling as an international currency. That dilemma made the way to the full convertibility of sterling a peculiar one. For instance, the "ROBOT" involved the application of a managed float as a means of reducing the balance of payments burden generated by convertibility. Moreover, in the "Collective Approach" that was designed so that both the U.K. and the Continental

European states would undertake external convertibility together, the U.K. was supposed to maintain import restrictions against its creditor countries such as the U.S. after the achievement of external convertibility.

Such an approach that explicitly reflected U.K. interests would not possibly be accepted by the Continental Europeans. Especially, some of them were concerned that the floating pound might dissolve the EPU that required a fixed rate system in its operation and strongly resisted Collective Approach. In addition, in January 1954 the Commission on the U.S. Foreign Economic Policy, the Randall Commission, reported a doubtful view and chilled the U.K.'s ambitions (Schenk 1994, pp.113-128; —2009, pp.102-112).

3.1.3 Stand-by Arrangement with the United Kingdom

Then, what did the Fund's staff think of the controversial U.K. plan? In fact, they had prepared to provide the U.K. with financial support and thereby compelled the U.K. authorities to undertake the Collective Approach. At first, Rooth planned to prepare a longer stand-by credit than six months.[9]

In August 1953, Rooth noted in his memo "several members feel that the period of six months is too short. It is felt that the brevity of this period limits the usefulness of the policy."[10] He called for an informal luncheon meeting during 1953 Annual Meeting and consulted with the representatives of major countries about this matter.[11] In this meeting, Leslie Rowan, the U.K. representative, strongly agreed the extension of stand-by arrangement, saying "the object of stand-bys for convertibility was to give confidence and a six month agreement would not do this." The other participants generally supported a longer stand-by credit, too.

Thus, at the Executive Board meeting in December 1953, the plan of a longer stand-by arrangement for convertibility was approved as follows; "If a member believes

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[9] Originally, the period of stand-by arrangement was decided to be within six months when it was created in October 1952.

[10] IMFA, Office of Managing Director Records/Ivar Rooth Papers/7.90, Stand-by Arrangement, August 26, 1953, p.4.

[11] IMFA, Office of Managing Director Records/Ivar Rooth Papers/11.162, Mr. Rooth's Luncheon-Meeting, September 13, 1953, p.6.

that the payments problems it anticipates (for example, in connection with positive programs for maintaining or achieving convertibility) can be adequately provided for only by a stand-by arrangement of more than six months, the Fund will give sympathetic consideration to request for a longer stand-by arrangement."[12]

In the spring of 1954, among the main staff, Rooth and the main staff of the Exchange Restrictions Department and the Research Department, a program to conclude a stand-by arrangement with the U.K. had begun to be progressed. Table 3.2 shows the draft design of the program prepared by the staff.

Table 3.2 Draft design of a stand-by arrangement with the United Kingdom

> After full discussion between the Fund and the United Kingdom concerning the program for convertibility of sterling, the following stand-by arrangement has been agreed :
>
> <u>Purpose</u>: The exchange available to the United Kingdom under this arrangement is to be used to support the convertibility program which the U.K. has informed the Fund includes the following major features:
>
> (a) The immediate rendering of sterling earned by Fund members on current account convertible into any member currency.
> (b) The progressive relaxation of remaining restrictions on the making of payments and transfers for current international transactions and restrictions on imports as rapidly as circumstances permit.
> (c) The adoption and maintenance of fiscal, monetary and credit policies in the United Kingdom that will promote the purposes of the Fund.
> <(d) Possibly a reference to the fluctuation of sterling, if any, in appropriate form.>
>
> <u>Remaining Exchange Restrictions</u>: The United Kingdom does not intend to take advantage for any further period of time of the transitional arrangements set forth in Article XIV of the Fund Agreement and has notified the Fund that it is

[12] IMFA, EBM53/95., "Use of the Fund's Resources", December 23,1953, p.3.

prepared to accept the obligations of Article VIII, Section 2, 3 and 4. The Fund has approved the maintenance of the restrictions on the making of payments and transfers for current international transactions now in effect, provided that the impact of these restrictions will not be intensified without prior consultations and approval of the Fund. The United Kingdom will relax and remove these restrictions as rapidly as circumstances permit and will consult with the Fund not less than every six months regarding such relaxation and removal.

Rates of Exchange: The United Kingdom intends to pursue an exchange rate policy consistent with Article IV, Section 3 and 4 of the Fund Agreement. If it should become necessary to allow movements in the exchange rates, the United Kingdom will before doing so consult the Managing Director of the Fund, inform him of the limits within which the value of sterling will be permitted to move and agree with him the conditions under which the United Kingdom will be prepared to stabilize the value of sterling at the existing par value or propose a new par value to the Fund. During any period when the exchange value of sterling is permitted to fluctuate the United Kingdom will remain in close consultation with the Managing Director and keep him fully informed on all matters affecting the movements of the rates of exchange.

Source: IMFA, CF C/ United Kingdom /1760, Secret (Stand-by arrangement with U.K-Draft), May 26, 1954.

As this table shows, the Fund's staff did not immediately deny the problematic ingredients of the Collective Approach. In fact, they could not figure out a clear solution on how to settle the matter of remaining import restrictions and the managed float, leaving everything to secret consultations between Rooth and the U.K. Chancellor of the Exchequer. Rooth and the other staff were eager for and gave first priority to sterling convertibility.

Meanwhile, the insufficient scale of the Fund placed fetters on realizing the stand-by arrangement. In a memorandum,[13] Bernstein, the Director of the Research Department, examined the feasibility of the stand-by arrangement in terms of the Fund's resources, as follows; "The present gold and dollar holdings of the United Kingdom or those likely to be reached by the end of this year are not adequate to enable the United Kingdom to undertake sterling convertibility. By a very restrictive credit policy, by close supervision of credit to foreign companies, and by making agreements on the drawing down of sterling balances, the magnitude of the capital outflow after the establishment of convertibility can to some extent be kept down. A significant capital outflow will, nevertheless, still take place. [...] To have adequate resources for convertibility, the United Kingdom must have dollar credits of not less than $2 billion and preferably as much as $3 billion." In the early 1950s, the U.K. gold and dollar reserves continued to be around $2~3 billion, while the sterling balances held by other than sterling area and dollar area also amounted to about $2 billion. The sterling balances, if they had directed to be converted into gold and dollars, easily could have drained the U.K. reserves.

Bernstein concluded that "It would be ideal if the Fund had the resources to provide the United Kingdom with all of the dollar credits required for convertibility. In fact, however, it cannot." At that time, though the Fund's total resources amounted to about $9 billion, the Fund's total holdings of gold, U.S. dollars and Canadian dollars amounted to only about $3 billion, and $400 million of them had already been drawn by the other members. In addition, Bernstein recognized that the uncommitted gold, U.S. dollars and Canadian dollars ought not to be much below $1.5 billion after concluding the U.K. stand-by arrangement in preparation for the needs of the other members. It turned out that the maximum amount the Fund could provide for the U.K. was less than $1.5 billion.

Until now, many scholars have described the IMF as a "Fund with no customer" in the early 1950s based on the fact that the drawings were leveling off in that period. On the contrary, however, the Fund's staff keenly felt a shortage of resources.

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[13] IMFA, Research Department Immediate Office/Department Director Edward M. Bernstein Subject Files/1, Notes on Sterling Convertibility, April 2, 1954, pp. 23-24.

In the United Kingdom, Richard Butler, Chancellor of the Exchequer, Cameron Cobbold, Governor of Bank of England, and only a few high officials seemed to be involved in the plan. While they fully understood that some financial support was indispensable for undertaking the Collective Approach, they began to hesitate over reliance on the Fund. Without the consent to the Collective Approach among the major countries, they might not restore external convertibility even if they concluded the stand-by arrangement. If they did not take steps within the period of stand-by arrangement, however, it would lead to lack of confidence in the U.K. authorities (Kaplan and Schleiminger 1989, pp.206-209).

Especially after 1953, Western Europe enjoyed favorable economic conditions. Inflation had gradually been brought under control and gold and dollar reserves favorably increased. Then, in 1954, the prospect for the end of the transitional period arose inside the Fund. So long as the Fund could not support the U.K. without its request, however, the realization of the stand-by arrangement would depend on the behavior of the U.K. authorities, whether they requested or not, and ultimately whether they could carry out the Collective Approach or not.

3.2 The Fund's Policy for Balance of Payments Adjustments

While the Fund's staff emphasized the effect of international cooperation on mitigating the dollar shortage, how did they understand the role of tightened economic policy on balance of payment adjustments? The U.K. government gave priority to full employment over balance of payment equilibrium. As early as in wartime, the government had proclaimed that it would seek to maintain high and stable employment, which continued to be a common object of both the Labour and Conservative parties. Even if it was inevitable to correct the balance of payments for exchange liberalization, for the U.K. it should be attained by the effort and/or of its creditor countries.

Faced with this expansionary policy in the 1953-54 consultations, the Fund's staff repeatedly warned that the U.K.'s full employment policy caused inflation and wage increases, thereby finally deteriorated its balance of payments. However, the U.K.

authority argued that the problem the U.K. economy faced was not inflationary pressure but the sign of recession.[14] Fig. 3.1 shows the unemployment rate gradually decreased and wage rate creeped up while the price level was relatively stable. Moreover, the Table 3.3 shows the U.K. current account which had recovered in 1953 again deteriorated in 1954.

In the autumn of 1954, Rooth made a speech at the Annual Meeting, as follows: "In making its currency convertible, a country indicates its willingness to expose its trade to world-wide competition. Such a country should buy its import, regardless of origin and of the currency in which payments are made, exclusively on a price and quality basis. [...] The need to sell in all markets under competitive conditions will compel it to maintain productive efficiency and to avoid an inflation of costs." (IMF 1954b, pp.12-16.). The Fund's staff concerned that the U.K. expansionary policy would spoil their plan for sterling convertibility.

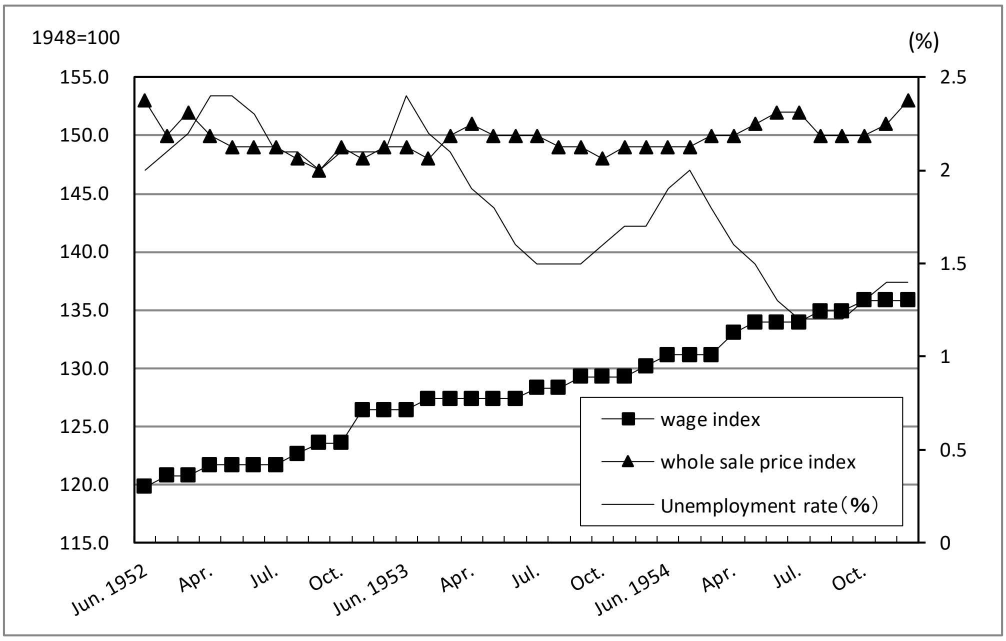

Fig. 3.1 The U.K. Wage, Price, and Unemployment in the early 1950s

Source: IMF (1952-1955). *International Financial Statistics*, Vol. 5-8.

[14] IMFA, C/U.K./420.1., Exchange Restrictions Consultations in 1953, Minutes of Second Meeting with U.K. Representative, July 18, 1953, pp. 7-9. —C/U.K./420.1., Exchange Restrictions Consultations 1954, Minutes of the First Meeting, November 8, 1954, p.5.

Table 3.3 The U.K. current account in the early 1950s (in millions of US $)

	1952	1953	1954
vis–à–vis the Dollar Area	−450	−11	−260
vis–à–vis the ROW	453	630	588

Source: IMF (1954-1957). *Balance of Payments Yearbook*, Vol.5-7. IMFA, SM56/17., Background Material for 1955 Consultations, Feburuary.16. p.52.

4 Exchange Liberalization at a Standstill; 1955-57

4.1 From Stand-by Arrangement to Monetary Approach

The U.K.'s expansionary policy, as the Fund's staff concerned, brought about a serious deterioration of its current account in early 1955. Moreover, in mid-1955, the rumor that the U.K. authorities would let sterling fluctuate to alleviate the current account crisis caused a severe run on sterling.

The U.K. crisis shadowed the prospects of the Fund's plan for a stand-by arrangement with the U.K. as the Collective Approach became harder to realize because of the repeated crises. In August 1955, the Western Europeans agreed to the foundation the European Monetary Agreement (EMA) as a successor to the EPU. The EPU would be transited to the EMA when the countries holding 50% of the EPU quota restored their currencies' convertibility. The 50% level implied that the roadmap of liberalization in Europe would be a collective process among the major three countries —the U.K. (25.5%), France (12.5%) and Germany (12%)—whose holdings amount to 50%. The agreement on the EMA discouraged the U.K. authorities from carrying out an ambitious Collective Approach (Kaplan and Schleiminger 1989, pp.210-226.).

Finally, the Fund's efforts to conclude a stand-by arrangement with the U.K. came to halt. However, as a condition of the transition to the EMA shows, it was obvious that sterling convertibility continued to be a key issue in the whole European liberalization process (Horsefield and De Vries 1969, Vol.2, p.274.). For the Fund's staff, sterling convertibility remained a keen interest.

Then, what did they recognize as the cause of the U.K. crisis and how did they promote its liberalization? The answers were shown in the "*Sixth Annual Report on Exchange Restrictions*" published in May 1955. In the report, the staff clearly indicated that the balance of payment disequilibrium was caused by the wrong macroeconomic policies and the members couldn't attribute it to postwar international circumstances any more, as follows; "As the effects of the destruction and disruption caused by the war increasingly disappear, the time is coming much closer when the postwar transitional period may end for all other members. [...] the use of restrictions as a means of coping with balance of payments difficulties was at best a temporary expedient, and that a sound external position could not be achieved without internal stability."(IMF 1955b, pp.1-13).

Thus, in the 1955 consultation, Irving Friedman, the chairman of the Fund's mission, requested that the U.K. should commit to stringent policies, stating "it was important to watch the situation closely and to continue an anti-inflationary policy [...] On the problem of wages which were of interest to the Fund since they bore on the United Kingdom's competitive position, the team felt that, under conditions of overfull employment, pressures for wage increases were almost inevitable. Such pressures could constitute a threat to the United Kingdom's competitive position. As to credit policy the team hoped that the tighter monetary policy was working as to be particularly helpful in strengthening the United Kingdom's balance of payments position. The team urged that the aim of achieving and maintaining internal equilibrium as a basic pre-requisite of balance of payments strength be kept." He concluded the consultation by emphasizing that the U.K. should progress exchange liberalization as soon as they overcame the crises.

The U.K. authority argued that the exchange liberalization would be difficult for a while.[15] However, it was inevitable for the U.K. to stop expansionary policy and to apply stringent macroeconomic policy against the serious crisis. The discount rate was raised (3→5.5%), bank credit was limited and the fiscal policy was tightened through

[15] IMFA, CF C/U.K./420, Exchange Restrictions Consultations 1955, Minutes of the Fourth Meeting, November 24, 1955, pp.3-7. — CF C/U.K./420, Exchange Restrictions Consultations 1955, Minutes of the Sixth Meeting, December 7, 1955, pp.5-6.

1955 and 1956.

It must be noteworthy that, in 1955, Polak, the Fund Research Department Staff, formalized new adjustment theory called Monetary Approach (Polak 1957). Based on the quantity theory of money, monetary approach incorporated the money and credit as determining factors which affected foreign reserves. At first, the output (Y) was defined in terms of quantity of money (Ms); $Y(t) = Y(t-1) + \Delta Ms(t)$. This equation described as, $Y(t) = Y(t-1) + \Delta D(t) + \Delta R(t)$ (D: bank credit, R:foreign reserves) because $\Delta Ms(t) = \Delta D(t) + \Delta R(t)$. If exchange rate was fixed and capital account could be neglected,[16] $\Delta R(t)$ would be changed solely by current account ($\Delta(EX(t) - IM(t))$, EX : export, IM : import). Then, increase of bank credit increases output, which would increase import in next period ($IM(t) = mY(t-1)$, m: import propensity, $0<m<1$) and hence would deteriorate current account.

Thus, this theory showed that bank credit to both private and public sector should be curtailed in order to improve balance of payments.[17] Based on this theory, the Fund mission began to emphasize the control of bank credit in consultations from the late 1950s.

4.2 The Fund as a Crisis Manager

Although in 1956 the U.K. external balances recovered, the economic stability never lasted. Through the late 1950s, the U.K. again faced two foreign reserve crises. The first crisis occurred later in 1956. In October, the U.K. incursion into Egypt in the Suez Affair undermined confidence among holders of sterling, which caused severe speculation on sterling. This military action also provoked strong objection by the U.S. government. The U.S. didn't want Arab nations, one of the strategic regions, to be hostile against the Western World. Federal Reserve pressed the U.K. to withdraw of their troops from Egypt by joining speculation on sterling (Grabbe 1996, p.15.). The

[16] Polak removed this assumption in the model presented in his recent paper (Polak 1998).

[17] In 1950s, Harry Johnson, a scholar in Chicago School also formulated Monetary Approach (Johnson 1958, pp.153-168). On the other hand, Polak argued that Johnson's model was Monetarist one which was different from his Keynesian version (Polak 2005, p.229).

U.K. foreign reserves were lost sharply and finally the U.K. government accepted withdrawal of the troops in early December.

As soon as the end of affair, the U.S. changed its attitude and financial assistance for the U.K. started. The U.K. authorities requested the Fund to purchase of $561.47 million and to agree a stand-by arrangement for $738.53 million. The Fund's staff immediately recommended to the Board of Directors that the Fund should approve the request, noting "Unless the decline in the gold and dollar reserves is checked, the U.K. will be faced with serious difficulties in re-establishing a surplus in its current balance of payments with detrimental consequences to the volume of world trade [...] This would seriously jeopardize the present freedom from restriction on trade and payments with the consequent loss of the progress thus far achieved in the attainment of the Fund's objectives."[18]

At the Executive Board meeting on December 10, Per Jacobsson, the third Managing Director, conferred with the Directors as to whether to approve the request. At the meeting, though some voices expressed disappointment that the Fund's resources wouldn't be used for sterling convertibility, the Directors unanimously approved the financial support to the United Kingdom.[19] With this funding, the speculation was quickly alleviated.

However, in the summer of 1957 a speculative run on sterling was brought about again. The widening of the EPU account imbalance among the U.K., France and Germany lay behind this crisis. While Germany became a large creditor, France widened its deficit with the EPU, which sharply expanded the regional imbalance in 1956. At that time in Europe, the discussion toward European integration (the European Common Market and Free Trade Area) was enhanced. The exchange market was filled with rumors of exchange adjustment to correct the imbalance before the integration, in other words, the market prospected revaluation of the deutschemark, devaluation of the franc and sterling would occur.

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[18] IMFA, EBS56/44supplement1, Use of the Fund's Resources-United Kingdom, December 7, 1956, pp.4-5.
[19] IMFA, EBM56/59, Use of the Fund's Resources- United Kingdom, December 10, 1956.

Faced with the outflow of gold and dollars, the U.K. authorities showed their intention to stabilize currency, taking measures of strictly tightened policies including a raise of the discount rate from 5 to 7%. Furthermore, at the Annual Meeting in the autumn, Jacobsson praised the U.K.'s action and completely denied the possibility of exchange adjustment (IMF 1957b pp.27-28.). A series of measures quickly suppressed the speculation in late September. After the crisis, the Fund continued to support the U.K. authorities by renewing the stand-by arrangement.

Through the late 1950s, the U.K. faced crises several times (Fig. 4.1, Table 4.1) and its exchange liberalization at a standstill. However, the crises were brought under control without the beggar-thy-neighbor policies by the U.K.. Some previous studies have noted that this crisis management helped the Fund recover from its reputation as "the Bank with no customer" or a "white elephant" (James 1996, pp.102-103). The Fund lending sharply revitalized (Fig. 4.2), which improved not only its reputation but the Fund's operational income and balance sheet in a critical condition (Table. 4.2).

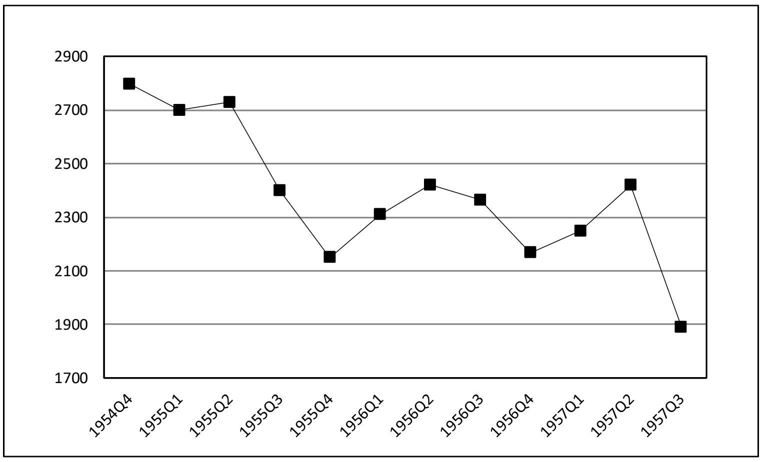

Fig. 4.1. The U.K. gold and dollar reserves in late 1950s (millions of US＄)

Source: IMF (1955-1958). *International Financial Statistics*, Vol.8-11.

Table 4.1 The U.K. current account in the late 1950s (in millions of US＄)

	1955	1956	1957
vis-à-vis the Dollar Area	−792	−64	−252
vis-à-vis the ROW	−148	829	932

Source: IMF (1957-1958). *Balance of Payments Yearbook*, Vol.9-10.

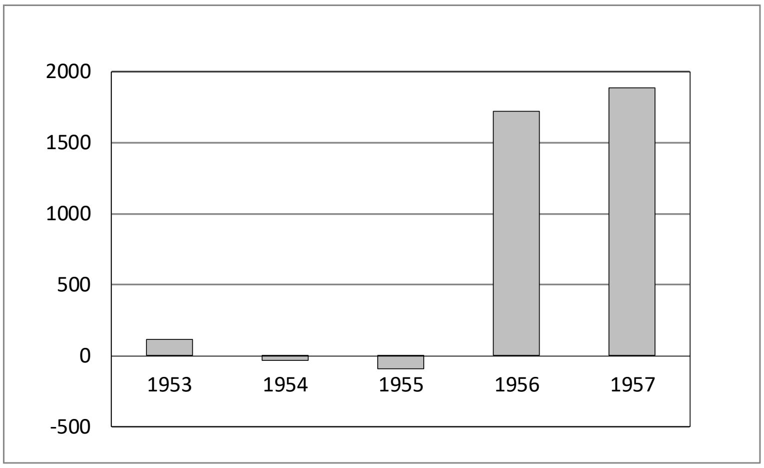

Fig. 4.2 The increase of the Fund's net lending in the late 1950s (in millions of US＄)

Source: Horsefield and De Vries 1969. Vol.2, pp.460-467.

Table 4.2 The Fund's balance sheet

	1953/54	1954/55	1955/56	1956/57	1957/58
ASSETS					
Gold	1,718,548,249	1,744,362,549	1,811,358,380	1,639,321,406	1,437,719,429
Currency and Securities with Depositories	6,232,515,417	6,299,748,936	6,105,937,766	6,463,542,261	6,755,651,816
Subscriptions to Capital-Receivable	888,796,461	797,671,444	818,179,579	819,770,400	900,723,488
Other Assets	977,296	948,953	1,092,975	4,595,557	5,520,918
Total Assets	8,840,837,424	8,842,731,883	8,736,568,701	8,927,229,623	9,099,615,652
CAPITAL, RESERVES, and LIABILITIES					
Capital	8,840,510,227	8,842,487,285	8,736,288,156	8,925,204,261	9,088,000,000
Reserves	133,177	84,184	111,037	1,450,140	10,945,183
Liabilities	194,020	160,415	169,508	575,222	670,469
Total Capital, Reserves and Liabilities	8,840,837,424	8,842,731,883	8,736,568,701	8,927,229,623	9,099,615,652
INCOME					
Income from Operations	4,970,490	2,329,758	1,551,777	8,384,865	20,250,155
Income from Investment	–	–	123,280	4,904,174	3,334,658
Other Income	14,710	16,668	279	335	497
Total Income	4,985,200	2,346,426	1,675,336	13,289,373	23,585,310
EXPENDITURE					
Board of Governors	139,066	171,004	347,160	178,898	196,011
Office of Executive Directors	730,076	705,373	747,299	793,507	840,627
Staff	3,365,243	3,336,485	3,542,587	3,650,176	3,859,083
Other Administrative Expenses	774,774	776,510	704,554	741,116	815,705
Gold Handling Charges and Exchange adjustments	856	1,372	8,414	19,906	13,937
Total Expenditure	5,009,159	4,990,743	5,350,016	5,363,696	5,725,363
Excess of Income over Expenditure	−24,815	−2,644,317	−3,674,981	7,905,772	17,859,947

Source: IMF (1954a, 1955a, 1956, 1957a, 1958a).

Meanwhile, such a large demand for the Fund's resources threatened the Fund's ability to support its members. Then, at the 1957 Annual Meeting, Jacobsson showed his concern that the increasing support would cause a shortage of the Fund's resources and mentioned the necessity of increasing the quota (IMF 1957b, pp.21-22.). In fact, the shortage reflected the progress of the exchange liberalization and the expansion of world trade. Meanwhile, the U.K. crises indicated the danger of an occurrence of sudden capital movement. In such a circumstance, the Fund needed larger resources to maintain the stability of the international monetary system.

5 Evolution of the Fund's policy in the Early 1960s; 1958-61

5.1 End of the Postwar Transitional Period

In 1958, the economic position between the U.S. and the Western Europeans was reversed. As figures 5.1 and 5.2 show, the Western Europeans recorded current surpluses vis-à-vis the U.S. and gradually accumulated foreign reserves. In contrast, the U.S. ran a current deficit vis-à-vis the Western Europeans and its foreign reserves peaked in late 1957, starting to decrease. At the 1958 Annual Meeting, Jacobsson proclaimed the resolution of the dollar shortage and that the time had come to realize a convertible world. In addition, he proposed the increase of the Fund's quota that came up for discussion at 1957 Meeting (IMF 1958b, pp.23-36.). The proposal was adopted at the 1958 Meeting, and in September 1959 the Fund's scale enlarged from about $9 billion to $14.5 billion.

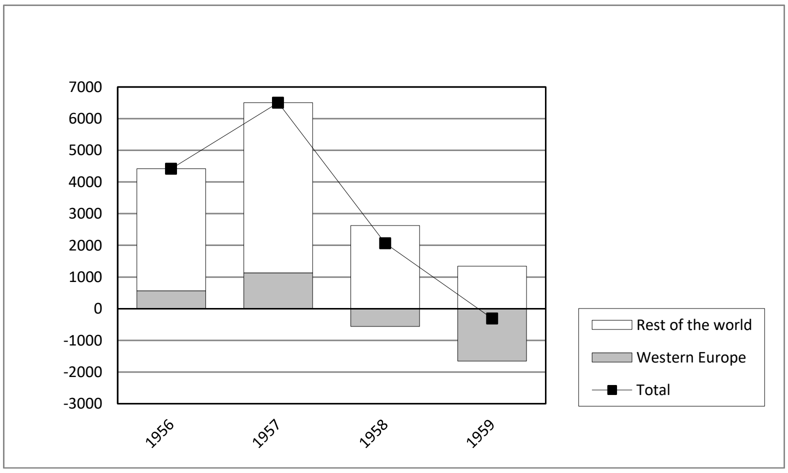

Fig.5.1 The U.S. current account in the late 1950s (in millions of US$)

Source: IMF (1957-1960). *Balance of Payments Yearbook*, Vol.9-12. Donations and grants were excluded.

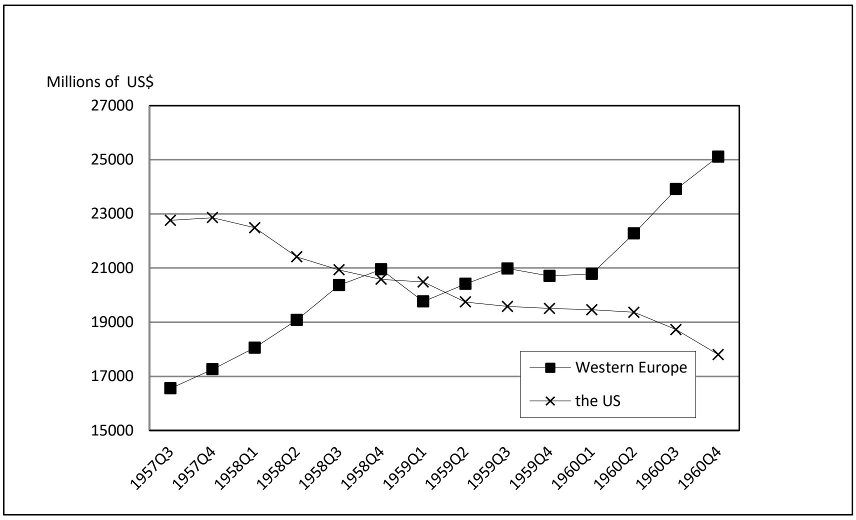

Fig.5.2 Gold and foreign reserves of major countries in the late 1950s

Source: IMF (1959-1961). *International Financial Statistics*, Vol.12-14.

Thus, in the late 1950s, conditions favorable to the establishment of the multilateral payment system were realized one after another. The momentum toward worldwide liberalization was gradually growing. On the other hand, in the U.S. and Canada a hostility grew against the discrimination practices against dollar area which Western Europeans still maintained.

In the 1958 consultation, the Fund's staff urged early convertibility of sterling and the abolishment of the U.K.'s remaining discrimination. In response, R. S. Symons, the U.K. chair, said the U.K. needed the Fund's financial support to go way forward, stating "It was necessary that adequate support should be assured. In this connection the stand-by arrangement was important and the proposal for an increase in the Fund's resources was also relevant."[20]

In December, after the consultation, the Fund received a request for a renewal of the standby arrangement from the U.K. authorities. The aim of this request was to prepare a buffer against the pressure on its foreign reserves that possibly would be brought about by exchange liberalization. All the Directors approved the request,[21]

[20] IMFA, CF C/U.K./420, Exchange Restrictions Consultations–1958, Minutes of the Fourth Meeting, November 24, 1958, pp. 6-11.

[21] IMFA, EBM58/59, United Kingdom-1958 Consultations, Repurchase and Stand-by Arrangement, December 19, 1958.

and soon after that sterling was restored to convertibility with other major currencies.[22] The Fund's policy that had been formulated by Gutt and Rooth finally supported sterling convertibility.

Thus, for Western Europeans, realization of external convertibility greatly reduced the meaning of dollar discrimination to protect their balances of payments. In December, at the 1959 consultation, the U.K. delegation announced that the remaining exchange restrictions weren't justified any more. In February 1961, the U.K. finally transited to Article VIII status with the other Europeans.

5.2 Speculative Capital Flow and the Crises Surges to Fore

For the Fund, the resolution of the dollar shortage was a prerequisite to compel its members to abandon restrictions. However, in 1960, soon after the dollar shortage ended dollar became excessive in the exchange market. In addition, exchange liberalization gradually gave rise to short-term and unstable capital movements (Horsefield and De Vries 1969, Vol.1, p.503.). As Eichengreen noted, it got much more difficult to control capital movement after current account convertibility (Eichengreen 1996, pp.120-125). Combined with these two changes, in the autumn of 1960, a Gold Rush was brought about in London (Fig. 5.3). The end of the transitional period was a prelude to the gold and dollar crisis.

Soon after European members transited to Article VIII status, Jacobsson started to take steps against the destabilization of the international monetary system. In a Board meeting in February 1961, he presented a paper titled "Future Activities of the Fund" and proposed that the Fund should (1) permit members to rely on the Fund's resources for capital transfer and (2) conclude standby arrangements with major members, thereby strengthening its crisis-response capability.[23]

[22] The name of the U.K. plan for sterling convertibility was "Operation Moonshine" and later changed to "Operation Unicorn". To carry out this operation, the U.K. authority had to keep pace with the other Europeans, especially France. There was harsh negotiation between them till the very last minutes before convertibility in December 1958 (Kaplan and Schleiminger 1989, pp.304-321.).
[23] IMFA, EBD61/18., Future Activities of the Fund, February 10, 1961.

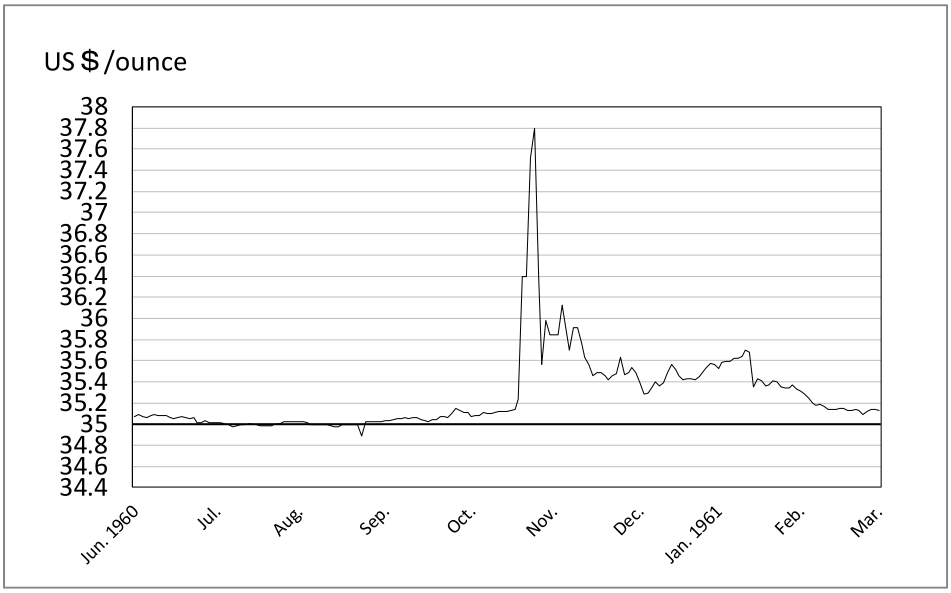

Fig. 5.3 The daily movement of the gold price in London

Source: Economist Newspaper, *The Economist*, 1960.1.2- 1961.12.30.

In fact, the first issue, financing of capital outflow, was prohibited in Article VI, Section 1, which set forth, "A member may not make net use of the Fund's resources to meet a large or sustained outflow of capital." In May 1961, the Fund's staff in the Legal Department, headed by the Director Joseph Gold, reinterpreted this sentence to mean that the Fund could assist in cases with no "large and sustained" capital outflows, which was approved at the Board in July 1961.[24] Then, the second subject, through strenuous disputes (Horsefield and De Vries 1969, Vol.1, pp.507-514, Vol.2, pp.373-377.), led to the General Agreement to Borrow (GAB) in October 1962. The GAB enabled the Fund to borrow at most \$6 billion from ten major countries in cases of urgent necessity.

Furthermore, Jacobsson promoted monetary cooperation among major countries. In March 1961, a run on sterling broke out after the appreciation of the deutschmark and the Netherland guilder. To support the U.K., major countries agreed to the "Basel Agreement." In July, the U.K. government requested the Fund to purchase \$1.5 billion in order to repay the borrowing under the "Basel Agreement." Jacobsson permitted the

[24] IMFA, SM61/45., Use of the Fund's Resources for Capital Transfers, May 24, 1961.

request and called for the support of the United Kingdom. In fact, the nine supporters together with the U.K. comprised the ten participants in the GAB, and the G10 grew out of these GAB participants.

At the 1961 Annual Meeting, Jacobsson described the dollar and sterling crisis as a brand-new affair, as follows: "The growing freedom for the international movement of funds, as a result of the increased convertibility of currencies, and the greater stability of prices—so welcome in themselves—have, however, created new problems which the world has not had to face since the start of the Second World War." Meanwhile, the response to the crisis was different from the international monetary reform like "Triffin's dilemma" indicated. Contrary to such a drastic method, Jacobsson advocated a policy to buttress the current system, remarking "a number of suggestions have been put forward advocating more or less radical changes in the existing monetary arrangements. It has been valuable that these matters have been so vigorously discussed, and the first question we have to ask ourselves is whether the present system can be regarded as operating in a manner sufficiently satisfactory to be worth maintaining. [...] On the whole, I believe the system has worked well. [...] In some quarters, doubts have been expressed whether the system under which countries hold part of their international reserves in currencies (which is known as "the gold exchange standard") will work satisfactorily in the longer run, and whether this system might not break down as it did in the interwar period. I do not think we need draw that conclusion" (IMF 1961, pp.15, 23-24.).

On the other hand, it was noteworthy that a series of policies didn't restrict but perceived capital movement. Chwieroth stated that as liberalization progressed, the Fund gradually perceived that speculation wasn't an abnormal phenomenon but rather an ordinary one and hence the regulation wasn't a fundamental solution but only a temporary measure (Chwieroth 2009, pp.121-137.). The Fund's view on capital movement had differed from the Keynes' one, one of the founders of the Fund that short-term capital would cause destructive results and restriction was needed. The change was also reflected in the formulation of the "Mundell-Fleming model,"[25] which incorporated the effect of capital movement into the IS-LM model, inside the Fund in 1961 (Boughton 2002).

6. Conclusion

As described above, in the Bretton Woods era, the IMF steadily formulated its policy framework. Conventional wisdom described that key currency approach crowded the IMF out of the framework of postwar international cooperation. However, the Fund's policy was forged from this distressed experience. Undermined in its position as an international monetary policy maker, the Fund had to cope with the problems in order to realize multilateralism. The problem was dollar gap, which couldn't be solved by the expected rule in Bretton Woods agreement; the IMF credit against short-term deficits and an adjustment of per value against fundamental disequilibrium.

Then, the Fund's staffs deceived a policy of international cooperation and of anti-inflationary macroeconomic adjustment with involvement in members' policy making. Through 1950s, the Fund's policy generally gave priority to stability of external balance and exchange liberalization rather than economic growth and full employment. In the *Globalization and its Discontents*, Joseph Stiglitz lamented that the IMF dramatically changed from good Keynesian in Bretton Woods era to anti-Keynesian in 1980s when Neo Liberalism gained power in Anglo-America (Stiglitz 2002, pp.12-13.). However, at least in 1950s, the Fund's stringent policy was deceived to limit Keynesian policy which primarily committed members' full employment and expansionary economic policies. Thus, we can find the gap between the idea and the reality in the Bretton Woods era.

Since the Breton Woods collapsed, the Fund has survived with evolving its organization. The Fund's Articles of agreement set forth that the Fund's purpose is to

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[25] IMFA , DM 61/28,. Internal Financial Policies under Fixed and Floating Exchange Rates, November 8, 1961. In this memo, Marcus Fleming, the Fund's staff of Research Department, compared the effect of monetary policy and fiscal policy under both fixed and floating exchange rate. He incorporated BP curve with upward slope to the right into IS-LM model, which reflected the rigidity of the capital movement at that time.

keep global financial stability by promoting international cooperation. Nobody argues this ideal itself and thereby the Fund has kept its raison d'être in a changing world. However, it has gotten much more difficult not only to lay solid foundation for international cooperation but to approach the Fund's purpose.

In the Bretton Woods era, the Fund had relatively small and homogeneous group of members and the U.S. hegemony was outstanding one as a key country. In addition, there was a general agreement about what international monetary system should be pursued; exchange rate stability, current account convertibility. These conditions facilitated international cooperation and gave room for the Fund's "one size fits all" policy being accepted by its members.

Meanwhile, now, the environment is totally different from the Bretton Woods era. The Fund's member has expanded into almost all over the world, which will tangle multinational cooperation. In addition, the international monetary system has metamorphosed into "Non System" with no "rules of the game" since 1970s (Williamson 1976) and increasingly becomes multipolar one. The IMF have to voyage on troubled water with no map and with several antagonistic captains, which will shadow the future of the New Bretton Woods.

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