

The Rise of the Dollar and the Decline of Sterling

(i) INTRODUCTION

This chapter will examine, through the story of the two main participants, the evolution of payments and the international monetary system between 1955 and 1964. This period must first be set in its total postwar context. The opening date, 1955, is chosen because it marks the end of what we may call the 'first dollar problem'. At, or near to, that time the American balance of payments changed from surplus to the deficit which was to increase and dominate the payments situation throughout the sixties and seventies. American accommodating finance to the rest of the industrial world ceased as it became unnecessary and the dollar became readily available either as a transactions or a reserve currency. Three years later, on 31 December 1958, the Western European currencies became convertible into dollars, thereby establishing, several years later than had been hoped,¹ the currency system agreed to at Bretton Woods. This tardiness in establishing the Bretton Woods system was, in great part, due to the delay in making sterling convertible. Our first task in this chapter then is to examine briefly the transition from the regionalised currency system of the fifties to the Bretton Woods world of the sixties.

In January 1959 began twelve years in which the main currencies (outside the Communist world) were freely convertible one to another and through the U.S. dollar, fixed in free exchange for gold at \$35 per ounce, indirectly convertible into gold. This dollar-gold exchange standard ended in August 1971 when the dollar was made inconvertible into gold and when the major currencies no longer maintained fixed parities with the dollar. Thus the twelve years 1959-71 may be regarded as the high summer of the Bretton Woods payments system centred around the IMF.

Once established, the Bretton Woods system became subject to a number of problems, some of which were eventually to bring it to an end. But for a number of years up to, say, 1964 it operated satisfactorily enough and contemporary observers would not have forecast its early demise. The IMF,

¹ Originally, under the Bretton Woods Agreement of 1944, convertibility of all members' currencies was to be established after a transition period of five years from the beginning of Fund Operations. The Fund opened on 1 March 1947, thus fixing the end of the transition period as 29 February 1952.

central institution of Bretton Woods, increased in influence and became accepted as a world body in currency matters. Moreover, international finance, which had long been regarded by national governments² as of secondary importance in international relations, was promoted to a primary role as its influence on economic growth, bargaining power and influence came to be realised. The years 1959-71 therefore mark a distinct epoch in postwar currency history, the period of trial, failure and collapse of the Bretton Woods system. In this chapter we carry the story to 1964, up to which the problems were largely those of reassessing the Bretton Woods principles in the light of events. In Chapter 12 we deal with the many crises to which the system was subjected in the later sixties and with its eventual breakdown.

(ii) ESTABLISHING CONVERTIBILITY

An observer of the international currency scene in 1955 might have been struck by four features which carried the promise of future change.

The first was the balance-of-payments position of the United States and the changing world role of the dollar. The acute and continuous surplus in the immediate postwar years after 1952 assumed manageable proportions. The years 1952 and 1953 saw a great improvement in the international payments situation. In Europe the OEEC countries, as a group, maintained an annual current account surplus of \$1.5 bln in 1953-4. The favourable balance of the United Kingdom was, at £225 m. in 1953, the highest since the war. Germany became a surplus country in 1951 but France, whose rate of growth was swift in the fifties, had recurrent balance-of-payments difficulties. Meanwhile, the export surplus of the United States shrank until, in 1953, the trade balance was in approximate equilibrium.³ In spite of a slight recession in the United States 1954 was a year of easy payments and although the Western European trade deficit with the United States came out at \$1423 m. it was more than covered by direct U.S. military expenditures in Western Europe of \$1431 m. The existence of certain government grants and remittances thus enabled European dollar reserves to be augmented.

During the later fifties the trend of improvement of the balance of payments of the non-dollar world with the United States continued, despite the minor recession of 1957-8 and the emergency imports of oil from the western hemisphere during the Suez Crisis of 1956-7. The year 1958 brought a sharp reduction of American exports, the fall continuing in 1959 while, on the import side of the merchandise trade account, imports remained on a slightly rising trend from 1957 to 1960. The changes in both imports and exports,

² Except France.

³ If military deliveries are excluded, the U.S. current balance changed from a surplus of \$1829 m. in 1952 to a deficit of \$62 m. in 1953.

which seem to have been due to changes in the trading position of the United States as postwar recovery strengthened in Europe, produced a trade balance quite insufficient to meet the external commitments of the United States on capital and military accounts. The result was the beginning of the loss of gold which the United States was to undergo throughout the sixties. In 1958 \$2275 m. and in 1959 \$1076 m. seemed small losses from a reserve of \$19.5 bln, but they were the beginning of a rising trend.

Thus by the end of the fifties the dollar problem had reversed itself and become a balance-of-payments-deficit problem for the United States. Seen at the time as a mere interlude in the earlier problem⁴ there was every reason to regard the reversal with equanimity and it was hailed as a welcome breathing-space. Now, in the perspective given by a quarter-century, the structural nature of the change is apparent. The current account surplus had become insufficient to finance capital and military outlays overseas. These were to increase and in the later sixties bear the burden of war in South-East Asia and recurrent waves of direct and indirect overseas investment.

One reason why even economists at the time welcomed the U.S. payments reversal was that it ended scarcity of the dollar as a currency. As long as strong U.S. surpluses lasted the dollar was necessarily in short supply; a currency to be hoarded, finding its way to banking reserves rather than into transactions uses. Once in deficit, dollar scarcity was replaced by foreign dollar balances which, as long as American reserves were not far short of \$20 b., were of unquestionable acceptance as international money. With the rapid expansion of the New York foreign-exchange and capital markets the dollar was able quickly to move into its Bretton Woods position as the leading international currency – this at a time when increasing doubts were being felt as to the future of sterling's key currency role. Convertible into gold at a fixed price and, after 1959, convertible into all other IMF currencies at fixed exchange rates, while backed by a gold reserve of unprecedented size, it is small wonder that the dollar stepped naturally into the place formerly held by sterling and prepared for it by the Bretton Woods Agreement.

The second notable feature of the payments scene in 1955 was the growing importance of West Germany and its currency. Transformed by the currency reform of 1948 the German economy expanded rapidly. After a brief period (1949 and 1950) during which this expansion caused imports to grow without any commensurate increase in exports, the German trade balance became favourable in the spring of 1951. This trade surplus was mainly the result of the steady expansion of exports. While imports rose from 1954 onwards they were, until 1958, outpaced by exports. During 1958, 1959 and 1960 West German trade was in surplus with every metropolitan EPU country as well as with the extra-European sterling area as a whole. With a net balance on invisibles of small dimensions the German balance of payments on current

⁴ Sir Donald MacDougall, in his *The World Dollar Problem* in 1957 (London: Macmillan, 1957), referred to the dollar (surplus) problem as one likely to continue in that form.

account was heavily in surplus and against such surpluses only small capital exports could be offset. The result was a massive addition to German foreign-exchange reserves.

The real strength of the German surplus was the very strong competitive position secured by the Germans for themselves in export markets, a position based upon the importance conceded to the 'export drive' by German industrialists, the competitive prices at which goods were offered, the short and well-honoured delivery dates for capital goods and the attention given to selling and marketing techniques. It was believed, particularly in the United Kingdom, that the German surplus would decline as the German economy moved towards the point of full employment; that (a) higher domestic production and income would pull in greater imports and (b) that the level of demand in the home market would pull goods away from the export market. The first of these changes occurred only slightly, the second not at all. By the spring of 1961 the German economy was the most fully employed in Europe with unemployment less than 1 per cent and with more than three vacancies for every single person unemployed. Yet this did not lead to any marked rise in prices nor to any foreign balance deterioration.

Three features of the German economy allowed expansion to continue without the expected 'heating-up' taking place: the influx of immigrant labour from Eastern Germany, the almost pathological fear of inflation by both Government and people, and the existence of certain built-in checks against inflation in the German economy, of which the high propensity to save and the low 'propensity to strike' of the German worker were the most notable.

Already in the fifties the German surplus was a structural problem in European payments and was the subject of continual criticism in the OEEC. To their credit the German Government was ready to acknowledge the existence of a surplus problem, and to take measures for its alleviation. It liberalised import policies and lent abroad in modest amount. But on the central issues – the DM exchange rate and the demand level, within the German economy – the Germans were adamant. To revalue the currency might imperil the export drive and offend a large industrial group which supported the Government. To expand the economy to the point where rising imports would eliminate the surplus would risk a rise in the German price level. Neither course was acceptable.

A third feature of the payments scene was the instability of the British balance of payments. In the immediate postwar period a large deficit was to be expected and in the circumstances the balance-of-payments performance for the five postwar years was not surprising. The country's power to export had been depleted by the war. Significant invisible items,⁵ such as earnings from financial services and foreign investments normally expected to offset the

⁵ For example, payments for shipping services, earnings from financial services and earnings from foreign investments all fell while government outlays overseas rose.

merchandise trade deficit, were now adverse and there was a high demand for imports of all kinds for capital reconstruction and consumption. But after the sterling devaluation of September 1949, with the war five years away and sterling realistically aligned with other major currencies, a more robust payments position might have been expected. In fact in the period 1950-64 what came out was a series of modest surpluses interspersed with four large deficits - the largest in 1964. Relevant to Britain's external equilibrium needs, estimated by the British Treasury in 1957 to be an annual current account surplus of £350 m., the result was poor indeed. In one year only, 1958, was this target met. Moreover, from the mid-fifties dates the long series of speculative raids on sterling which were to be such a damaging and persistent feature of the currency and a thorn in the flesh of British policy-makers throughout the sixties.

Table 8.1 summarises the British balance of payments between 1952 and 1964. At first sight the current balance, with three exceptions, seems satisfactory enough. It is only after considering certain special aspects of sterling's position that a truer picture emerges. First, among such special aspects was the fact that Britain continued into the postwar period her role as an exporter of capital but whereas in the interwar period this debit item in the capital account was offset by a large enough current surplus, in the postwar period surpluses were insufficient. The net result was one of imbalance. Second, Britain was committed under the Bretton Woods arrangements, and by her own interpretation of sterling's position as an international currency, to maintain a fixed exchange rate. This meant that rolling adjustments to the balance of payments could not be made through the exchange rate, but had to be met from foreign-exchange reserves which were perennially insufficient to meet such demands. This adjustment problem was compounded by the British Government commitment of 1944 to maintain a high level of employment after the war. This had been interpreted by both political parties to imply an unemployment rate of less than 3 per cent and in fact the rate was held well below that figure. It would be possible to extend this long list of special commitments bearing on the British balance of payments - the large British military presence abroad, the pursuit of an international role for sterling, the promise to the United States to establish and preserve convertibility of sterling - all these underscore the fact that only a rich and economically well-endowed country could pursue such roles simultaneously.

The fourth feature of the payments system in the later fifties was the proliferation of new international organisations, particularly in Europe. These were to play a role in events. In a similar category, influencing international monetary policy, was the re-emergence of central bank co-operation. The Marshall Plan, which had been launched in 1948, had led to elaborate organisation of the joint European effort for reconstruction. The Organization for European Economic Co-operation (OEEC), was responsible for co-ordinating many aspects of co-operative economic planning

TABLE 8.1
U.K. Balance of Payments, 1952-64
(£ m.)

	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964
Imports (f.o.b.)	3048	2927	2989	3386	3324	3538	3378	3640	4141	4045	4098	4370	5016
Exports and re-exports (f.o.b.)	2769	2683	2785	3073	3377	3509	3407	3522	3733	3892	3994	4287	4471
Visible balance	-279	-244	-204	-313	53	-29	29	-118	-408	-153	-104	-83	-545
Invisible balance	442	389	321	158	155	262	318	267	150	158	231	199	143
Current balance	163	145	117	-155	208	233	347	149	-258	5	127	116	-402
Balance of long-term capital	-134	-194	-191	-122	-187	-106	-196	-255	-192	68	-98	-155	-374
Balance of current and long-term capital transactions	29	-49	-74	-277	21	127	151	-106	-450	73	29	-39	-776
Errors and omissions	66	32	57	121	42	80	64	-28	292	-34	60	-71	45
Balance of monetary movements	95	-17	-17	-156	63	207	215	-134	-158	39	89	-110	-731

Source: Central Statistical Office, *United Kingdom Balance of Payments* (various years).

while functional agencies such as the European Payments Union (EPU) were responsible for technical operations each in their field. The Bank for International Settlements returned to the stage both in connection with EPU operations and as a centre for central bank meetings through the Basle Club. The fifties then, although a period during which the IMF and the Bretton Woods arrangements were in abeyance, were of great importance in the development of international economic co-operation. But they shifted the focus of co-operation to Europe and they weakened the Fund by its virtual exclusion from what became for the time being the centre of monetary affairs.⁶

We have set the international monetary scene in the fifties rather carefully because it is important to realise just what was taking place during the decade which it took to establish full convertibility between the leading currencies. In Chapter 3 we described the effects of the premature American drive to bring this convertibility about and the disastrous failure which it involved for Britain in 1947. In the next section we describe the more methodical and sure-footed approach to the same problem in the fifties.

iii) BRETTON WOODS AT LAST

The American contribution to the attainment of convertibility in 1958 was low-key. On the European side the desirability of making currencies convertible, for at least current transactions, was acknowledged but, in the light of British experience, there was tacit agreement to 'hurry slowly'.⁷ The British, despite their failure in 1947, were anxious to make sterling convertible for the increased importance this would give to the currency. From 1955 there was a loose agreement between Britain and the United States, that each by their policies would contribute to a so-called 'collective approach' to sterling convertibility. In the meantime EPU and the sterling area, linked through British participation in the former, provided a wide geographical convertibility between (a) all Western European currencies, (b) sterling, (c) all overseas sterling-area currencies, and (d) some few other currencies linked to

⁶ This exclusion was largely due to the American decision that countries in receipt of Marshall Aid should not receive assistance from the Fund. Between 1948 and about 1955 the Fund's business with and interest in Europe was much less than it should have been.

⁷ A precise definition of currency convertibility is difficult to state briefly. The convertibility sought in the immediate postwar period, and which we have so far been discussing, was a qualified one, being for non-residents only. A brief working definition which may serve is that convertibility in a currency is the power of exchanging it freely in a public exchange market for other currencies.

Not until February 1961 did sterling and the other leading Western European currencies assume full responsibilities of Article 8 of the Fund Agreement. From December 1958 until that date they operated under Article 14, which allows countries suffering from balance-of-payments difficulties to contract out of the obligation of full current-account convertibility. This distinction was largely a legal one.

sterling through 'administrative control' of the Bank of England. Between this large currency group and the dollar, however, there was no convertibility. To bridge this gap was the final task and much of the weight of it fell on the British. If full convertibility for all these countries were to be established prematurely, i.e. while the world at large had still a preference for dollars over other currencies, much of the sterling balances held by other countries would be quickly converted into dollars to the detriment of the British balance of payments and the sterling exchange rate.

Attention in the movement towards convertibility centred on sterling. As early as 1951-2 there were discussions between Britain, the United States and the IMF. The British approach was clearly to test the waters (of the exchange market) by slowly allowing limited free markets for sterling to arise. In these, as expected, sterling was initially at a discount to the dollar relative to the official rate appropriate to the IMF parities. But if, as sterling strengthened with a favourable balance of payments, the 'free' rate moved to coincide with the official rate, then full convertibility would be feasible. In December 1951 British banks were allowed to hold balances of currencies and deal in foreign exchange on a very limited basis. By 1954 in New York, Zürich and elsewhere, transferable sterling could be changed into dollars on free markets in which the rate in March 1954 was only at a discount of 1 per cent. In later 1954 and in 1955 balance-of-payments problems widened the discount to 2 and 3 per cent, but in February 1955 the Bank of England began to intervene in the free markets to support the free rate. This was a move of far-reaching consequence since the British Government was now virtually supplying dollars freely at a rate only slightly less than that on American account sterling. Convertibility seemed imminent, indeed sterling was *de facto* convertible. But *de jure* convertibility had to wait three more years. In late 1955 and in 1956 there was a renewal of the sterling area's foreign balance problem and of dollar shortage: in 1956 the external problems created by the Suez adventure and in 1957 the speculation against sterling all forced a holding action upon the Government. Not until December 1958 was sterling strong enough for a declaration of *de jure* convertibility for non-residents, bringing to an end the free markets in sterling abroad and centring exchange dealings in normal markets. The politics behind the final move towards convertibility are obscure but it is probable that, at some time in 1958, Britain promised the Americans that they would make a declaration of convertibility as soon as possible in return for American support for a revision of quotas in the IMF.⁸ In the final event convertibility came upon sterling rather differently than had been expected. After years in which hopes of its achievement had ebbed and flowed with the fortunes of the British economy the final approach in 1958 was steady and gradual. Precipitated as it finally was by certain French and Western European currency reforms it came at last

⁸ Under its new liberal lending policy begun in 1956 the IMF was by this time in need of more currencies to lend—hence the move for a revision of the original quotas.

almost as a contingent measure. It provided us for the first time with an international currency system broadly in conformity with the ideals of Bretton Woods.

(iv) PROBLEMS TO BE FACED

The main features of the monetary scene in 1959 were perplexing rather than threatening but, in the main, the mood was optimistic. The salient features in the landscape of international finance were these. The United States, now a deficit country was, through its deficit, supplying dollars to a world which, for the present, was prepared to regard and use the dollar as a key currency. The British, despite recurrent balance-of-payments problems, were anxious to see sterling play an important role as a second key currency and looked forward to growing influence for the City of London now that exchange controls had been largely dismantled. Two other important currencies were emerging on the world stage - the Deutschmark and the yen - both of which, on the basis of market penetration and a huge export trade were to play an increasing role.

Apart from what we may call the 'externalities' of world finance there was the domestic condition of the IMF, which if not the leader, was at least to be the hub of the Bretton Woods system. Here, as on the wider scene, there were grounds for caution, but not for despondency. The influence of political forces upon the Fund, which Keynes had feared, was strong in its operations from the outset. The overwhelming political, economic and military dominance of the United States in the postwar years, its preponderant voting power in the Fund and the Fund's location in Washington ensured that it should be inordinately influenced in this period by the Americans. Although American dominance in the Fund diminished in the sixties, political conditions and influences continued to shape Fund policies and decisions.

Convertibility brought the Fund back to the centre of events. Since 1956 its position had been strengthened by the increase of its activities and the growing acceptance by member countries that it had a useful role to play. Now, in 1959, two technical considerations called for attention. First, it was clear that, if the Fund was to supply currencies in accordance with a reasonably flexible policy, its international liquidity holding had to be increased, either by a revision of quotas, by borrowing from richer members or by sponsoring the creation of a new international reserve unit. Second, there was evidence that the exchange-rate policies of the Fund were unsatisfactory. The exchange rate would have to be brought into play as an adjustment mechanism to aid member countries in achieving balance-of-payments equilibrium. As the Fund administered it, the exchange-rate system gave rise to currency speculation; and the Fund's arrangements with member countries for the changing of exchange rates were unsatisfactory, usually resulting in the country concerned taking unilateral action.

Finally, the Fund had, in the light of more than a decade's experience, a

number of housekeeping matters to attend to. There was need to adapt its attitude towards controls, discrimination and restrictive currency practices to suit the new world of freer trade and payments which appeared to be evolving in 1959. Clearly this could not, as some Americans had thought, be its main work. Circumstances were forcing upon it the more central tasks of exchange-rate supervision and adjustment which Keynes had originally seen as central to its efforts.

Of all questions for the Fund in 1959 that which loomed largest was the provision in the world monetary system of an adequate and well-distributed supply of international money. In 1948 the ratio of gold and key currencies held by countries and international organisations to world imports was 80 per cent; by 1957 it was only 51 per cent. With the expansion of trade in the sixties it was to fall still further. This 'international liquidity problem' had several facets and it is worth while looking at these in turn. First, however, a general overview to put the various elements in perspective.

In a world of fixed exchange rates deficits and surpluses in a country's balance of payments result in additions to or diminution of its foreign-exchange reserves, as its monetary authority intervenes in the exchange market to maintain the exchange rate. Under Bretton Woods principles the need for international liquidity was maximised (a) because exchange rates were fixed in all but the very long period, (b) because direct controls on balances of payments were precluded under the Fund agreement, (c) because leading countries were pledged to policies of full employment and (d) because, during the early life of the Bretton Woods system, trade had been expanding.⁹ Thus the problem was, in its simplest form, to increase the total quantity of international liquidity in order to give greater freedom of manoeuvre to individual countries in their balance-of-payments policies, especially to prevent them resorting to controls or disorderly currency practices which would threaten the whole system.¹⁰

In the real world, however, the international liquidity problem had other aspects than that of the simple aggregate. International liquidity was not a

⁹ The expression $D_t = f[\sum_n B_t, B_t, F]$ summarises the world demand for international liquidity, where D_t is the demand, B_t is the balance of regular transactions, B_t the balance of settling transactions and the sum of $(B_t - B_t)$ for the n countries of the world system is the total of residual balances requiring settlement. F is the total volume of world trade.

There is no reason to expect that imbalance tends to increase with trade volume. It is dominantly the size of fluctuations in balances of payments (i.e. $B_t - B_t$) which determines D_t . But the disaster model is certainly one in which the volume of trade is very large and balances of payments are unstable as well.

¹⁰ To many economists the international liquidity problem was irrelevant and could have been avoided completely by reverting to a regime of freely floating exchange rates under which balance-of-payments adjustment was achieved by a free exchange market and no reserves were necessary. Such was the view of the 'monetarist school' (led by Chicago economists H. G. Johnson and Milton Friedman), which carried this politically naive view of the perfection of market mechanisms to many conclusions in regard to economic policy throughout the sixties and seventies. It is necessary to note that a large number of economists who led the early intellectual revolt against fixed exchange rates (e.g. Meade) did not carry their arguments to the same conclusions but argued rather for a more flexible system than Bretton Woods with more effective use of exchange rates to influence balances of payments.

homogeneous element: it consisted of gold, key currencies—the U.S. dollar and the pound—three elements of varying attraction and acceptability, between which holders might switch in accordance with subjective assessments. Initially, in 1959, the switching problem was seen as one of two key currencies. The new world was to be a dual-currency world in which the dollar and sterling would be the key currencies. It was conceivable that a dual-centred currency system would result in a never-ending see-saw in which funds moved restlessly backwards and forwards between the two currencies with unstabilising effects for them and for the whole system. This proved to be a fear only partially justified in practice. Although the early sixties with its recurrent balance-of-payments problems for sterling did see that currency persistently weak relative to the dollar, it was the events which followed the sterling devaluation of November 1967 which are the keys to the breakdown of the Bretton Woods system. These events may be regarded as an aspect of the switching problem, expressing lack of confidence not in one of the key currencies but in both. The years from 1967 were to see a confidence problem of a new and more devastating kind—a propensity on the part of holders of international balances to seek security outside the key currencies altogether, either in gold or other temporarily preferred currencies. There was, indeed, a switching problem among the constituents of international liquidity, but the switch was different from what had been expected.

But these recondite aspects of the Bretton Woods system were not perceived as of great immediate concern. The simple problem of providing an adequate amount of liquidity in the light of an expanding volume of world trade claimed attention. The sixties saw a recognition of this problem and persistent efforts to solve it—by the institution in 1961 of the General Arrangements to Borrow (GAB) within the IMF, by further increases in Fund quotas in February 1966, by measures for intra-central bank co-operation and by the creation in 1967 of a new form of international liquidity through the Special Drawing Right (SDR). Efforts to expand the world stock of international liquidity were continual and widened in scope throughout the sixties. The major efforts will be dealt with each in their place. That which belongs to the very early sixties is the so-called GAB arrangements of the IMF.

The IMF existed, in part, to augment the reserve holdings of its members who might purchase from it, up to the limit of a quota, currencies which for the moment were scarce to them. Since a small group of currencies were in continual demand the resources of the Fund, in particular of these currencies, were crucial if it were to fulfil its role as a supplement to individual country reserves.¹¹ Means of increasing these usable resources were limited to two: by increasing the quota contributions of members or by borrowing from members. The 'increase-of-quota' route was followed but was insufficient. In

¹¹ This role was at best a peripheral one. Even in 1973 after the inclusion of SDRs the Fund commanded only 15.7 per cent of total world liquidity.

1959 soon after a general quota increase¹² it became apparent that, in the new convertible conditions, and with mercurial balances of payments there would be great demand for supplies of the leading currencies. The question of how to meet this demand was then a special one, apart from the general question of international liquidity. Of the methods open to it, the Fund elected to use the power to borrow from its members given to it under its founding agreement.¹³ According to a staff report of April 1961 it was estimated that, over and above its normal holdings, the Fund would require about \$2 bln in U.S. dollars and \$3½–5 bln in currencies apart from dollars and sterling. Credit lines should therefore be sought from leading members, each for its own currency. The amounts of each currency borrowed would have to be settled by negotiation, in which account would be taken of the country's quota and the size of its reserves. After negotiations lasting four months, on 20 December 1961, the GAB were approved by the Board. These provided for loans, on demand by the Fund, by ten countries of their currencies amounting to \$6 bln. Precise conditions as to the loans, their repayment, conditions and servicing were made in the agreement.¹⁴

The agreement of 1961 was a watershed in the Fund's development. Apart from their functional aspects certain principles were implicit in the arrangements. First, it was now acknowledged that there must always be a limit to the resources the Fund might command from quota subscriptions,¹⁵ and that these might well be insufficient to supply liquidity in the leading currencies. Second, from a system of supplementation through borrowing to one of supplementation by credit overdrafts or drawing rights was not a great step and in this sense the GAB may be seen as a logical forerunner of the SDR scheme which was to come in 1967. Finally, with the supply of currencies by member countries went power for the suppliers. The GAB gave formal recognition to an asymmetry which existed in the Bretton Woods system, in that while there are scores of currencies in the world (and in the Fund) there is but a small number which are of real importance. The Fund, as an organisation of (at that time) seventy-one states, had entered into an agreement with a group of its richest members, to augment its resources and contribute to one of its most important functions, the supply of currencies to members. It could have been foreseen at the time—perhaps it was foreseen¹⁶—that the group of members concerned, not only by reason of their new role but

¹² Further quota increases were to take place in 1966, 1970, 1975 and 1980.

¹³ See Article 7, Sec. 2 (i).

¹⁴ For a more detailed account of GAB, see W. M. Scammell, *International Monetary Policy: Bretton Woods and After* (London: Macmillan, 1975), pp. 195–8.

¹⁵ Even if it were politically feasible to raise these periodically.

¹⁶ According to Horsefield, Mr Per Jacobsson, the Fund's managing director, had his doubts of the wisdom of group decisions within the Fund. He laid down certain principles to which any agreement which he was prepared to submit to the Board must conform. One of these was that 'the Authority of the Fund must not be impaired'. See J. K. Horsefield, *The IMF 1945–65* (Washington, D.C.: I.M.F., 1969), vol. 1, p. 511. See also Erin E. Jacobsson, *A Life for Sound Money: Per Jacobsson. His Biography* (London: Oxford University Press, 1979).

by their dominant voting power, would become the political driving force of the whole IMF. As the eventual Group of Ten they were destined to exert a formative influence on Fund developments in the later sixties.

Return now to the general picture of the new convertible system. It is possible to sum up the problems of this system as they were to be throughout the sixties in one question: how, with fixed exchange rates, were strong and weak currencies to co-exist?¹⁷ In this respect the sides were already picked: sterling long in difficulties, the U.S. dollar now a deficit currency still enjoying world confidence as it surged to prominence as the leading key currency on the basis of a burgeoning overseas banking network, but destined for trouble as its deficit grew and became chronic; the Canadian dollar geared to its U.S. counterpart but since 1951 outside the IMF because of its free exchange rate; on the side of the strong, the Deutschmark, soon to be joined by the Japanese yen, as currencies based on apparently impregnable trade balances, the Swiss franc, secure on neutrality, conservatism and the safest of banking systems. Round these the lesser fry grouped and re-grouped according to fortune and the run of events.

Between 1959 and 1964 the vital currency was sterling. Had the pound been capable of assuming the role of key currency to which the British Government aspired, had it been backed by a stronger balance of payments, more skilful monetary policy and had it not been subject to repeated speculative attacks by lagged payments and hot money movements, then the suspicion which clouded it would probably not have been extended to the dollar later in the decade. As it was the period from 1959 to 1964 was punctuated by recurrent sterling crises which marked the end of its career as a key currency.

The British deficit on current account in 1960 was the largest since 1947, and 1961 was a year of rearguard actions to save sterling from devaluation.¹⁸ On 4 March 1961 the German monetary authorities revalued the Deutschmark by 5 per cent. A few days later the guilder was similarly adjusted. A general realignment of currency values was now anticipated and considerable speculation resulted, much of it concentrated in selling pressure on sterling. So far as that currency was concerned British policies were simple. Their leitmotiv was to be the preservation of the external value of the pound,

¹⁷ It must be stressed that the words 'strong' and 'weak' refer here to currencies within the small group of the leading dozen or so currencies of the world. Obviously strong and weak currencies can and do exist among the large number of peripheral and less-important national currencies which are not heavily traded on the foreign-exchange market and are neither key currencies nor vehicle currencies.

¹⁸ The language here is deliberately chosen to recall the dramatic style used by writers and politicians of the sixties to dramatise exchange-rate crises. Harold Wilson spoke of 'dying in the last ditch with sterling'; an American foreign-exchange dealer at the New York Federal Reserve spoke proudly of engaging in the battle to save sterling using language adapted from Henry V's speech before Agincourt. An exchange rate was cast as a national symbol to be defended. To speak of it as a price in a market for currencies was to be prosaic if not unpatriotic.

to which overriding objective British domestic industrial and monetary policies were to be subjugated. In part this decision was due to the British desire 'to retain in London an international financial centre of the first rank and with that to maintain a fixed exchange rate';¹⁹ in part it was the expression of an old belief that devaluation of a currency was not a weapon of policy but the final and ultimate economic disaster to be avoided at any cost.²⁰ Persistent British refusal to use devaluation and the persistent belief of speculators that she could not avoid it was a determinant of important events in the sixties. The Americans suffered from the same myopia, believing in fixed exchange rates and the maintenance of the sterling parity as the first bastion in defence of the dollar.

Co-operation among central banks saved sterling from devaluation in 1961. In the face of a statement by central bank governors, meeting in Basle, that no further changes in exchange rates were contemplated speculation ceased. A week later the Basle Club announced that existing rates were to be supported (a) by swap arrangements whereby central banks would support each other's currencies by holding balances of these currencies rather than changing them into gold or dollars and (b) by short-term lending to countries whose currencies were under speculative pressure. This so-called Basle Agreement of March 1961 saved sterling and with American initiative inaugurated a phase of central bank co-operation in support of weak currencies which lasted up to sterling's eventual devaluation in November 1967.

Despite this organised support sterling could not sustain its position as the second key currency. The currency was under constant scrutiny and frequent speculative attack. The balance of payments was in bare surplus (averaging £83 bln) between 1961 and 1963, but in large deficit (-£402 m.) in 1964. There was constant tinkering with domestic economic policy, largely in the hope of impressing the world at large of the British Government's determination to manage their way to stability. It was of no avail. Deficits continued in 1965 and 1966 and sterling was devalued by 14 per cent in November 1967.

It is tempting to seek explanations for the persistent weakness of sterling during the years 1960 to 1967. Certain structural weaknesses in the British balance of payments have already been discussed, and these played their part. It may well be that, come what might, these weaknesses would have been conclusive. But it is fair to say that throughout the period the British Government had to play a subservient role to the Americans, who not only directed the defence of sterling but refused to contemplate a change in the exchange rate as a viable solution. Certainly between 1964 and 1967 the

¹⁹ R. E. Caves *et al.*, *Britain's Economic Prospects*, chap. iv, 'The Balance of Payments', by R. N. Cooper. Washington, D.C.: Brookings Institution, 1968, p. 153.

²⁰ The same belief that made Britain return to the gold standard in April 1925 with sterling over-valued at the prewar exchange rate of \$4.86 = £1 rather than at some rate in accord with 1925 prices and costs.

Americans soldiered manfully on, organising both in the Basle Club and in the Fund measures for sterling's support. Between 1961 and 1964 the IMF granted three one-year stand-by arrangements for Britain and during 1964 the Fund implied by its attitude that it would go to the limit to help preserve the sterling exchange rate. The reason for this was simple. The Americans (and the Fund) believed and as it transpired, they believed correctly, that if sterling were to devalue the result would be a heavy blow not only to world confidence in sterling, but to confidence in the whole international financial structure.

Gold transactions and the gold market were a necessary part of the Bretton Woods arrangements and it is necessary at this stage to go back a little and examine the role of gold in these arrangements. To do this is but to recur to the problem of international liquidity, which involved not only the volume of such liquidity but the relative acceptability of its constituent parts, gold and the key currencies. The switching problem whereby gold, the dollar, sterling and other currencies, were to be seen as alternatives for settlement or for holding international balances, was already becoming apparent in 1960. We take up the story in March 1954 when the London gold market was reopened.

Between March 1954 and late 1960 the gold price in the London market did not move outside the prescribed Fund limits (\$34.65 - \$35.35 an ounce) and kept even within the narrower limits of the U.S. Treasury's buying and selling prices. In late 1960, however, the price began to move upwards under the influence of steadily rising demand and by 17 October the London price passed the U.S. Treasury price plus the cost of transatlantic freight. By 20 October the price exceeded \$40 for the first time. Much of the new demand was due to the belief that the American Government would shortly increase the price at which it sold gold at the Treasury. Such a price increase had been advocated for years as a means of increasing the value of international liquidity and in spite of repeated denials by the U.S. authorities it was widely believed that sooner or later the price would be raised. Official reaction to the price rise in late 1960 was a denial, by Kennedy himself, on 6 February 1961. This, together with tight restrictions on gold dealings by American nationals and corporations, halted the price rise for the time being.

By August 1961 the price was moving upwards again and, on American initiative, it was decided to expand the supply side of the market. Hitherto the supply had come from the Bank of England augmented from time to time by the U.S. authorities. Under a new arrangement the central banks of Belgium, France, Germany, Italy, Holland, Switzerland, Britain and the United States were to share the job of price stabilisation in the market by acting as a sales syndicate. This Gold Pool operated for the first time in November 1961 and remained in operation until March 1968 although France, who had her own ideas on gold policy, left in June 1967.

The pressure of rising gold demand was incessant during the sixties. At the U.S. Treasury the attrition of reserve encashment, begun in the early fifties,

continued²¹ while, in the free market, movement into gold by hoarders and pressure from industrial users increased. From 1966 private demand for gold exceeded new output and the Gold Pool had continually to make use of their gold reserves to hold the price to the required \$35 level. After sterling's devaluation in November 1967 the movement into gold became a stampede. By mid-March 1968 the Gold Pool had lost \$2.75 bln in supporting the free market and it ceased operation.

By 1964, five years after general convertibility and the establishment of the Bretton Woods system, that system was already in some disarray. Of the two leading key currencies, one was patently declining and unequal to the role for which it cast itself; the other, while seemingly still impregnable, was nervously contemplating the prospect that soon it would have to carry the whole weight as centre currency of Bretton Woods. Already the old mystique of gold as the only acceptable form of wealth was manifesting itself as a movement away from the key currencies. But at the heart of it all was imbalance among the balances of payments of the leading industrial and trading countries. Germany, with the chronic surplus which began in 1951, to be joined in the late sixties by Japan; Britain far gone in decline now joined by the United States with its swollen capital export and public sector expenditures; France, ever ready to use international finance as a major vehicle of foreign policy - all this was the raw material of crisis and breakdown. There were more stresses than the international system could handle. With the afterknowledge of history it is hard to understand why contemporaries did not, in 1964, interpret the march of events as we do now - as a process leading to inevitable breakdown in the seventies. The reason for this myopia is simple. Trends are not easily interpreted in their beginnings, least of all in international economics. The international monetary system is a state of continuous makeshift in which views, actions and policies have frequent changes of course. In 1964 such a change of course was still seven years ahead and the world did not look bound for hell. The short-term view looked difficult rather than menacing.

The Western world had weathered the war, and its aftermath. Reconstruction was now virtually complete. There had been only limited and local disasters. Unemployment, the bane of the thirties, had been banished by Keynesian controls of the macro economy and replaced by unprecedented growth in trade and output. The price pattern which had accompanied this was a mild inflation in which prices would double only in a quarter-century. If the international payments system could not easily accommodate all this it would be surprising. The new Bretton Woods procedures were having their teething troubles, but these could be met and with suitable modification all would be well. Such was the mood of 1964.

To crisis we return in Chapter 12. We end this chapter on a cheerful note

²¹ Between 1950 and mid-1968 the U.S. gold stock was run down from \$23 bln to \$10.5 bln.

with a brief description of the economic growth of the sixties which contemporaries saw as its sparkling feature.

(vi) GROWTH AS NEVER BEFORE

By the late fifties the strongest expansion of output and trade in modern times was well under way. It was to continue into the seventies but interrupted by the inflation and recession which began in 1973. The early years of this expansion have been dealt with in Chapter 5. In this section it remains only to summarise (with the aid of Tables 8.2-8.5) the distinctive features of the whole period from the end of the war to 1970 as follows:

(i) The years 1945-55 can be set aside as the period of recovery from the war. Nevertheless the rates of growth of production in most countries during this period were higher than might have been expected in a period of such confusion and 1938 rates of output were reached surprisingly quickly. By 1955 recovery was virtually complete and longer-term influences were clearly at work.

(ii) The trend rate of growth of GDP for the leading industrial countries²² over the period 1955-68 was 4.7 per cent. Around this average there was some dispersion. Significantly lower rates were recorded by the United States, the United Kingdom and Belgium; higher rates by Japan, Germany, France, Italy and the Netherlands. The Japanese rate - more than twice the average - was accounted for by the phenomenal industrial growth of that country in the later sixties. One important feature of postwar growth was the economic resurgence of Europe. The growth rate of Europe's output in total (5.5 per cent a year) and *per capita* (4.4 per cent) was far above the world average. By 1970 output per head was nearly 2½ times its level in 1950.

(iii) High rates of growth were recorded by countries which were in process of industrialisation, for example France, Italy, Portugal, Spain and Japan.

(iv) Disaggregation reveals that for the group (and for almost all individual countries) industrial output grew more rapidly than total output, while agricultural output grew less rapidly. The high rates of growth of output per employed person were in part due to shifts of workers from agriculture to higher productivity industries.

(v) Breaking the decade of the sixties into two quinquennia it is notable that, except in the cases of Japan and Italy, growth rates were slightly lower in the later years. In part this was due to the existence of some underemployment in certain industrial countries, notably the United States, in the early years, which enabled high growth rates to be achieved as the economies moved to full employment in the mid-sixties. In the later sixties action to restrain

²² Taken here as the OECD group.

TABLE 8.2
Growth of Output of OECD Countries, 1960-70

Country	1955-68	1960-65		1965-70	
	GDP	Output per employed person	Total output ¹	Output per employed person	Total output
Canada	4.5	2.6	5.5	1.5	4.4
United States	4.0	3.1	4.8 ²	1.8	3.7 ²
United Kingdom	2.8	2.2	3.0	2.9	2.4
Japan	10.2	8.7	10.1	10.8	12.4
France	5.7	5.2	5.8	5.2	5.3
Germany	5.1	4.4	5.1 ²	4.4	4.3 ²
Italy	5.5	6.2	5.1	6.8	6.3
Belgium	3.9	4.1	5.2	3.6	4.2
Denmark	4.8	4.0	5.2	-	4.1
Netherlands	5.1	3.6	5.2	4.3	5.0
Norway	4.5	4.3	4.9	3.7	4.4
Sweden	4.5	4.3	5.3	3.2	3.7
Switzerland	4.8	3.0	5.2	3.3	3.2

¹ Gross domestic product at factor cost, 1963 prices.

² Gross domestic product at market prices.

Source: OECD, *The Growth of Output, 1960-1970* (Paris: OECD, 1970), compiled from tables 2 and 3, pp. 22 and 25.