Preface

The big message of this little book is that history must be read carefully for its policy implications. I take as my foil a series of articles by Michael Dooley, David Folkerts-Landau, and Peter Garber, three authors who have influentially used the history of the Bretton Woods international monetary system that operated from the late 1950s through the early 1970s to make some points about the operation of today's international financial system. Then as now, according to Dooley, Folkerts-Landau, and Garber, the United States occupied an asymmetric position at the center of the international system, running balance-of-payments deficits, providing international reserves to other countries, and acting as export market of last resort for the rest of the world. Other countries kept their currencies pegged to the dollar. They were reluctant to revalue even in the face of chronic American balance-of-payments deficits and even where they enjoyed relatively rapid productivity growth for fear of interrupting the process of export-led growth and suffering capital

losses on their foreign reserves. The original Bretton Woods system, based on these structural factors, endured for many years. The implication is that the new informal Bretton Woods system that has developed spontaneously in recent years is likely to prove equally durable. To put it another way, since structural factors underlie the current pattern of exchange rates (undervalued Asian currencies and an overvalued dollar) and global imbalances (Asian surpluses and U.S. deficits), this situation is likely to endure for a considerable time to come.

As always, the closer one examines a history, the more complicated it appears. On closer scrutiny, important differences are apparent in the structure of today's world economy compared to the 1960s. Taken together these factors point to the conclusion that the current constellation of exchange rates and payments imbalances is unlikely to persist for as long as the original Bretton Woods system.

A broad overview of these differences is provided in chapter 1. Subsequent chapters then develop the contrasts in more detail. Chapter 2 examines the Gold Pool, the collective agreement through which the central banks of other advanced nations attempted to resist the temptation to diversify their reserves out of dollars into gold and thus to prevent their currencies from rising. It suggests that the history of the Gold Pool is less than reassuring for those who believe that contemporary central banks will continue to act collectively to support the dollar. Chapter 3 examines the case of Japan, a country that had long pegged its currency to the American dollar and pursued a

policy of export-led growth but that revalued and then floated in 1971 to 1973. Its history suggests that it is possible for a rapidly growing, export-dependent economy to exit from a peg without killing the golden goose of growth and that differences between Japan then and China now make this potential scenario even more likely today. Chapter 4, finally, draws out the implications of the fact that today, unlike in the 1960s, there exists a full-fledged rival to the dollar in the form of the euro.

Each of these chapters illustrates the power of historical analogy in informing interpretations of current circumstances and future prospects. But the power of analogy resides not just in drawing out the parallels between two historical settings but also in highlighting the differences between them. It is those differences and their relatively pessimistic implications for the prospects for the dollar and the world economy that are emphasized in this book.

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Some of the chapters were tried out on other audiences at earlier dates. Chapter 1 was the basis of my Thornton Lecture to the Cass Business School at City University in London, while chapter 4 is a revision of my Tawney Lecture to the annual meetings of the Economic History Society in Leicester, England. I am grateful for the reactions of both audiences.

Chapter 3 was written jointly with Mariko Hatase of the Bank of Japan, who very graciously agreed to its inclusion here.[1] For help with sources, I thank Robert Solomon and Piet Clement. I also acknowledge permission to refer to materials from the U.S. National Archives, the Bank for International Settlements Archives, and the Public Record Office in London. At the MIT Press, Elizabeth Murry and her efficient staff made the transition from manuscript to book as painless as possible. I am grateful to them all.