The Collapse of the Bretton Woods System in the Early 1970s Contributed Positive Impact to International Political Economy
การล่มสลายของระบบเบรตตันวูดส์ในช่วงต้นทศวรรษที่ 1970 สร้างผลเชิงบวกต่อเศรษฐกิจการเมืองระหว่างประเทศ

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บทคัดย่อ

บทความนี้มีวัตถุประสงค์เพื่อวิเคราะห์ผลกระทบหลังจากการล่มสลายของระบบเบรตตันวูดส์ ภายใต้แนวคิดอุดมการณ์เสรีนิยม เพื่อที่จะเข้าใจถึงระบบของเบรตตันวูดส์ว่าสามารถส่งผลกระทบต่อเศรษฐกิจโลกอย่างไร โลกของเราได้เผชิญกับการเปลี่ยนแปลงเป็นอย่างมากในเวทีเศรษฐกิจนับตั้งแต่การล่มสลายของระบบเบรตตันวูดส์ ซึ่งหลังจากการล่มสลายของระบบเบรตตันวูดส์ ระบบการแลกเปลี่ยนที่ตายตัวถูกแทนด้วยระบบการแลกเปลี่ยนแบบลอยตัว ในมุมมองของอุดมการณ์เสรีนิยม ระบบอัตราแลกเปลี่ยนแบบใหม่นี้สามารถเป็นตัวขับเคลื่อนที่ดีในการพัฒนาอุดมการณ์สรีนิยมให้มีความแข็งแกร่งมากยิ่งขึ้น อย่างไรก็ตาม การล่มสลายของระบบเบรตตันวูดส์ยังได้นำมาซึ่งปัจจัยลบบางประการ ซึ่งเห็นได้จากจำนวนนักเก็งกำไรที่เพิ่มมากขึ้นทั่วโลกและยังมีผลกระทบทางด้านการเคลื่อนย้ายเงินทุนอย่างเสรี

ผลของการศึกษาทำให้เห็นการล่มสลายของระบบเบรตตันวูดส์ ในแง่บวกจากมุมมองของทฤษฎีเสรีนิยมเนื่องจากระดับความร่วมมือระหว่างรัฐต่าง ๆ เพิ่มขึ้นอย่างมาก ซึ่งสามารถลดความเป็นไปได้ที่จะเกิดวิกฤตเศรษฐกิจซ้ำซาก หากโลกยังคงใช้ระบบเบรตตันวูดส์ ระบบเศรษฐกิจโลกจะมีความร่วมมือระหว่างประเทศน้อยลงภายใต้ระบบอัตราคงที่และทุกอย่างยังคงขึ้นอยู่กับการตัดสินใจของสหรัฐอเมริกา

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Abstract

The article aims to analyze the impact after the collapse of Bretton Woods system under the liberal's ideology in order to understand how the Bretton Woods system can affect on global economy. The world had undergone substantial changes in the economic arena since the collapse of Bretton Woods system. The fixed exchange rate system was replaced by floating system. In liberal's ideology, the new exchange rate system was a good element to flourish its ideology. However, this also brought about some negative factors as can be seen from the increase in the number of speculators and the impact on capital mobility.

The result of the study views the demise of the Bretton Woods system in a positive light from a liberal theory viewpoint- as the greater degree of cooperation between states had done a great deal to decrease possibility of recurring economic crises. If there was still a 'Bretton Woods' system the global economy would be less international cooperation under a fixed-rate system, and everything would still depend on the decisions of the U.S.

Keywords : The Bretton Woods system, The floating system, Capital mobility, Liberal ideology

Introduction

In terms of liberal theory, it emphasizes the market role as the centre of the economic sphere, with the individual being more important than the state itself. Cooperation can build mutual benefit, and transnational cooperation can stimulate capital flow around the globe. State intervention is unacceptable, and cause the failure of the economic system. In comparison, free trade can benefit the economic system. According to Adam Smith (as cited in O'Brien and Williams, 2007)

stated that a laissez-faire doctrine (liberal theory) aimed to demonstrate the benefits of individual liberty and a free market economy which minimized governmental interference in the economic affairs of individuals and society.

In 1944, the Bretton Woods system was constructed by the U.S. Since then the U.S. has become the main actor in the system. The era from 1940-1960 can claimed to be as the era of unchallenged hegemony. This is because the U.S. was the main actor in managing the International Monetary system. The U.S. dollar became the world currency because it was fixed to gold at a rate of $35 to one ounce of gold (Engel, 1986). Moreover, The U.S. lent a hand to 16 European nations to recover from the war by providing $13 billion under the Marshall Plan for 4 years (History.com, 2009). Thus, the economic, investment and military spheres were dominated by the U.S. In 1960, the 'Bretton Woods' system began to decline because of heavy U.S. expenditure on the Vietnam War. This caused a deficit in the U.S. current account, but also allowed Japan and Western Europe to stage their post-WWII recoveries. The Deutsche Mark and the Yen then become more competitive with the dollar. Hence, the U.S. hegemony to have been under stress since 1960. The big challenge arrived in 1971; the U.S. experienced the worst trade deficit in its history. The U.S. realized the fixed rate system could not reflect the real world situation. The rate should be flexible according to economic growth. The Deutsche Mark and Yen were undervalued. In contrast, the U.S. dollar was overvalued (Gray, 2007). This caused the price of U.S. products to be higher than the market standard. Finally, President Nixon decided to end the fixed rate system, and the U.S. dollar became free floating (O'Brien and Williams, 2007). The system was changed to a floating exchange rate system which supported financial liberalization, including the free flow of capital. Above all else, the 'Bretton Woods' system was markedly controlled by the U.S. The impacts after the collapse of the Bretton Woods system can be analyzed into two directions which are positive and negative impacts. The main argument of this article is to prove that the collapse of the Bretton Woods system contributed more on positive impacts rather than negative impacts in International political economy.

Positive Impacts of the Collapse of the Bretton Woods System

With the collapse of the Bretton Woods system, there was a move from a fixed exchange rate to a floating exchange rate system. The World was wide open for each state to have more competition within its economy, with less government intervention. This caused many positive changes to the world from a liberal perspective as follows.

1. A Realistic Exchange Rate without State Intervention

The cessation of the fix-rated system helped every state to realize the realities of the economic arena. The pegged rate was an exchange rate between currencies under government constraint, which also relied on the gold standard. Hence, the pegged rate did not always represent a realistic exchange rate. In addition, the pegged system could be considered to carry the potential risk of balance of payments disequilibrium, which can occur when exchange rates are not changed to reflect price changes, This occurred with the U.S. dollar, the Yen and the Deutshe Mark during the last phase of Bretton Woods after the U.S. realized they could no longer hold the pegged rate at $1 per ounce. The pegged system was said to be suitable for developing countries in order to persuade foreign companies to invest with confidence, because it could prevent daily fluctuations (Heakal, n.d).

In contrast, the floating system created market-clearing and an automatic equilibrium in the balance of payments. Under the floating system, these outcomes are achieved automatically without the need for government intervention. In comparison, with fixed exchange rates, it is not normal to experience balance of payments equilibrium (McGregor, n.d.). Advocates of the floating system also claimed that “a flexible rate would allow countries autonomy with respect to their use of monetary, fiscal and other policy instruments by automatically ensuring the preservation of external equilibrium” (as cited in Tsoukalis,1985 : 105).

Above all else, it was considered the above factors to be positive outcomes from the liberal perspective because without a pegged system currencies would experience more realistic exchange rates that reflected the current situation in the world. Moreover, government intervention was abandoned after the change to the floating system. Hence, countries were able to realistically match supply and demand. Generally speaking, the floating exchange rate found in a free market can be termed “self-correcting” (Heakal, n.d.: 1).

After the collapse of the system, major countries adopted this system as their economic policy instead of the fixed-rate system. During the 1973 oil crisis, fixed- rates caused major problems- with some countries becoming uncompetitive because of their high inflation rates. Hence, a floating rate system is a more suitable tool to allow countries to have more flexibility in dealing with crises. Sohmen (as cited in Chipman and Kindleberger, 1980) states that floating rates provide greater insulation from external shocks and that monetary policy is more effective under a floating rate system. The floating system can be considered as compatible with liberal principles because this system supports the market as a mechanism to set the exchange rate- unlike the fixed-rate which is controlled by government. Ricardo and Smith (as cited in O'Brien and Williams, 2007) state that economic prosperity is more likely to occur when governments refrain from intervention in markets. During the Bretton Woods era, many developed countries also agreed that the liberal international economic system required governmental intervention. The role of government increased in the national economy, the government had a reponsibility to assure a degree of economic well-being of their citizens. The system of economic protection for at-risk citizens was so-called the welfare state. This became a popular demand for governmental intervention in the economy, which supported theory of Keynesian school of economics. Keynesian school emphasized on the need for governmental intervention to counter market imperfections (O'Brien and Williams, 2007). However, the increasing of government intervention in domestic economy created problems that had a profoundly negative effect on international economics.

Obstfeld (as cited in Truman, 1994) states that the design of the Bretton Woods system made it incapable of handling major changes in the global economy and in the mobility of capital. The most positive aspect of the collapse of the Bretton Woods system was that, with the death of interventionist approached, economies could adapt to market forces more automatically.

2. Decreasing U.S. Hegemony

Under the Bretton Woods system, it was widely perceived that the U.S. was the dominant country because all currencies were treated unequally; the U.S. dollar became the pivot of the system with its price tied to gold (Bird, 2001). Bretton Woods was established by the U.S. and Great Britain. Since the British had suffered from WWII and could no longer compete with the U.S., they were in debt to the U.S. As a result, the U.S. took the major role within the system. Odell (1988) also states that the United States was the leader to create the Bretton Woods system in 1944 because it had hegemonic and overwhelming power over other states. This statement can be seen as evidence to support my argument that during the Bretton Woods era the U.S. was a powerful country, but that Post-Bretton Woods it lost that power. Bordo (1995) states that the collapse of the system marked the end of U.S. financial dominance. This had already discredited the American role in the world, in spite of the U.S. having emerged as a major power in the post World War II era.

After the collapse of the system, there was more opportunity for other currencies to take a more active role in the economic arena. In Europe, there was an idea to form their own common currency after the floating period in the early 1970's. The EEC intended to use their new Euro currency to recover the exchange rate stability of the past. On 1 January 2002, the Euro currency was launched under the Maastricht Treaty. For the time being, the Euro had more stability and their exchange rate was stronger than before. The Euro eventually became a major currency to compete with the U.S. dollar.

Not only was the Euro trying to compete with the U.S. dollar, but also the Yuan- in spite of the Chinese ability to achieve their goals through low-wage labor. Chinese products continue to be cheaper than the same products from other countries. In future, the Chinese have the potential to overtake the U.S. economy. Moreover, after the post-cold war era china launched a good neighbor policy which helped its economy a great deal in the long run (Chen, 1993). The decline of U.S. hegemony continued. The gap in exports between the U.S. and other countries widened considerably up to 1970 (The U.S. Department of State, n.d.), but then narrowed again after the 1973 oil crisis-when the U.S. economy came to a sudden halt. This oil crisis occurred as a result of the dollar being overvalued, as the oil price was traded in dollars at that time. This meant that oil producers were receiving less real income for their oil. The U.S. decision to maintain an overvalued dollar would eventually return to have a negative impact on its own economy (Gonzalez and Folsom, 1989). After that, many countries experienced for themselves the flaw in the U.S. fixed-rate policy.

This policy served only to protect U.S. interests, without any concern for the side effects of its decisions on others. Odell (1988) mentions that U.S. proposals under the Bretton Woods system were designed to benefit and protect its own interests in particular. Thus, many countries became increasingly unwilling to continue to accept the ways of the U.S. Many industrialized countries, such as the European countries and Japan, started to become more competitive with the U.S. after their Post-War recovery. Odell (1979) states that the United States had been gradually losing its power to maintain its status quo because Europe and Japan had recovered and had become new competitors in the economic sphere.

Moreover, in 1982, the U.S. faced the worst recession in its history (Odell, 1988). Since then, the U.S. has borrowed about $100 billion a year, and has this gotten into debt with other nations for the first time since 1914 (Gardner, 1985). As a result, the U.S. has lost its control over the world and has not been able to regain its overwhelming global power state. Since the collapse of the Soviet Union, Japan and Western Europe have shown themselves to be capable of making their own decisions-independent of the U.S. In discussing the decline of US Hegemony, some might argue that the U.S. remains powerful, especially on the changing role of IMF, later on WTO and World Bank in1990s. Nevertheless ,there is a new comer China who is ready to compete with the U.S. in economic arena. Although U.S. still controls over these global institutions but compared with the era of Bretton Woods, U.S. power was not as high as it used to be.

As a result in the 90s, the world changed to become a multipolar system in the economic arena. As a result, this was the starting point of the decline in U.S. hegemony which began after the collapse of the Bretton Woods system. This can be claimed as a positive outcome from the liberal perspective. According to the liberal institutionalist Keohane (1984), the decline of U.S.

power provided an opportunity for other states to gain influence, providing greater room for international cooperation. This greater degree of cooperation between states heralded a new era in the global economy, with other countries no longer being subjected to U.S. hegemony.

3. Increasing Capital Mobility and International Cooperation

The limited mobility of capital was one obstacle which occurred under the Bretton Woods system. This led to the problem of destabilizing capital flow. This was claimed as a result of the "lack of an adequate adjustment mechanism" (Gavin, 1996 : 5). This caused payments imbalances and also created a threat to exchange rate stability. During the Bretton Woods period, governments Usually controlled capital flows across their countries because it was easier for them to calculate the fixed-exchange rates of their currencies. These interventions eventually undermined the system of capital mobility, and led to its collapse. This collapse was a positive development from a liberal perspective because it eventually led to greater capital flows- which eventually led to greater international cooperation. And this has increased the number of transnational corporations, and has boosted the global economy through the transfer of capital and technology- unlike the fixed-rate system, where international cooperation was constrained by the state (O'Brien and Williams, 2007). As a matter of fact, when there is more cooperation, there is generally more peace in the world. Kant (Panke and Risse, 2007) states that liberal economic theory, in conjunction with more trade and economic cooperation, can create a more peaceful world.

Negative Impacts from the Collapse of the Bretton Woods System

Having considered the positive impacts from the demise of the Bretton Woods system, now the negative impacts will be reviewed.

1. Increase of Speculators

Currencies under the floating system often fluctuate, making it difficult to make trade plans. In the 1980s, this floating rate and its system created severe problems for the U.S. economy. The U.S. Central Bank made a decision to raise the interest rate to reduce the inflation within the country. But it did not turn out as expected because foreigners and speculators started to invest more in the U.S. dollar. This, in turn, caused the dollar exchange rate to rise, with the U.S. eventually ending up in a trade deficit. The U.S. government then started to build trade protection for its products (The U.S. Department of State, n.d.). Within the floating system, speculators have a bigger role, because there is less regulation to control them. These speculators may also take the form of financiers, hedge fund operators and international bankers (Gilpin, 2001). George Soros was the most famous of such speculators. He made a profit by selling the pound (O'Brien and Williams, 2007). As a result, the pound sterling fluctuated wildly. These speculators not only caused financial turbulence in Europe, but also in America. U.S. President Clinton tried to launch a policy to weaken the U.S. currency in order to boost the economy. He was unable to achieve this goal because the federal governments' power over the economy was by this time greatly diminished. In this case, to fix the exchange rate was more difficult - because more speculators had begun to play a role in the economic arena. As a result, these speculators created a loss of stability in the exchange rate system.

2. Impact on Capital Mobility

Under the floating rate regime, there were fewer restrictions on capital flows. Hence, money was able to move around the globe with greater ease. To analyze this issue from a liberal perspective, a free market with no government intervention and less restrictions on capital flow will make the economy flourish. This theory is more appropriate to the trading of goods rather than to financial markets- because it is very hard for developing countries to protect their vulnerable currencies on financial markets. Moreover, Miller (1995) said that international financial flows are now very large, and have grown rapidly in recent time - far beyond the control of most governments. An example of the impact on capital mobility was the financial crisis in Mexico during the mid-90s. Investors had a big role in creating this crisis, as we know that under a floating system there are fewer restrictions on capital flows. So this opened up channels for these investors to flow their money into the stock market in order to boost share prices and to allow them to sell the Mexican Peso in large quantities whenever they so desired. The state and government did not have enough power to stop the investors' actions. These actions can be claimed to be the starting point of the financial crisis. O'Brien and Williams (2007) state that although Mexico was committed to capital mobility, it was unable to prevent the crisis which was caused by rapid capital flows. From this statement, we can see that capital mobility is hard to control under a floating- and so countries can easily be plunged into crises.

3. The Possibilities of a Financial Crisis Occurring

After the collapse of the Bretton Woods system, the old regime was replaced by a floating system- with the lifting of restrictions on capital controls. Nevertheless, these changes also had negative impacts resulting in the constant possibility of financial crises. For instance, the 1997 Asian Crisis (Wade, 2000) in which the Thai government decided to float the baht and stop pegging their currency with the U.S. dollar- when faced with a severe financial problem. Later on, the whole of Asia experienced a domino effect- which some how called "Tom Yum Goong effect" (in Thai). The whole of Asia suffered from this disease and it took many years to recover. This was an obvious. crisis which was affected by the floating system.The Asian crisis in 1997 happened because the world had moved away from a fixed-rate into a floating system after the demise of Bretton Woods. The floating regime opened path for speculators to play a greater role in the economic arena. And this combined with the weakness in capital mobility which had already discussed in the previous section. Both of these reasons were the us of the Asian crisis.

Nevertheless the speculators on the other hand, they bring in an economic benefit. Nowadays, stock prices, exchange rates, oil prices, commodity prices or interest rates are economic values that impact a large number of people. The risk to economic activity from unknown future prices is largely controlled by speculative activity. Although, the floating regime opened path for speculators to play a greater role in the economic arena and might caused the finacial crisis. But these speculators are also important to free market because they bring liquidity and assume actual market risk.

Conclusion

Throughout this paper, it has provided both positive and negative impacts of the collapse of Bretton Woods system. As we now know the Bretton Woods system was one that benefited the U.S. The U.S. played the prominent role throughout the Bretton Woods era. In addition, the U.S. role was in decline at the time of the collapse of the system. That collapse moved the World towards the new era which we now call the ‘post Bretton Woods era’ - which has in turn further promoted a liberal economic ideology. The fixed-rate system has changed to a floating system, which provides more realistic exchange rates without state intervention. The increase in capital mobility and International Cooperation are all elements which also supported the liberal ideology. Nevertheless, there are negative effects that have arisen from the Post-Bretton Woods era. These include increasing speculative activities in the economic sphere, the recurrence of financial crises and the impacts of capital mobility.

Overall, this paper views the demise of the Bretton Woods system in the positive light rather than in a negative one. If there was still a ‘Bretton Woods’ system the global economy would not be the same as the one we see today. There would be less international cooperation under a fixed-rate system, and everything would still depend on the decisions of the U.S. The world would also still be under the influence of a unipolar system, unlike the multipolar system today. Although the U.S. is still a major power in the world, some of its power has now been distributed to other states too. The U.S. is still the most powerful nation in the military sphere, but U.S. power in the economic sphere has dramatically decreased since the collapse of the Bretton Woods system. Lastly, this paper views the demise of the Bretton Woods system in a positive light from a liberal theory viewpoint- as the greater degree of cooperation between states had done a great deal to decrease the possibility of recurring economic crises.

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