The Causes of the Collapse of the Bretton Woods System and Its Influence on International Relationship

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Abstract: The Bretton Woods System was formulated by Britain and the United States and other countries before the end of World War II, and it could keep the worldwide hegemony of the United States and was closely related to the economic development and post-war pattern of each country. However, in the 1960s, the weaknesses of this system were showed through the Triffin problem. Besides, there were obvious institutional defects as for this system. All of these led to the collapse of the system under the circumstance of uneven development of capitalism. Although the system has already got out of the stage of history, it still influences the economic recovery of various countries around the world, and it is significant to enhance the international power and change the post-war pattern.

Keywords: Bretton Woods System; Cause of Collapse; International Relationship; Influence

The international monetary and financial relationships in the 1920s and 1930s showed an extraordinary disorder. The United States began to prepare for establishing the international monetary system before the end of the Second World War. The pillar of the Bretton Woods System was the US dollar, which could greatly and strongly push forward the external economic expansion of the United States. It also required all of the countries to pay funds in order to establish the Foreign Exchange Stability Fund of the United Nations, and directly determined the right of voting and the right to speak out as per the payment share of the fund[1].

1. Reasons for the collapse of Bretton Woods System

During the World War II, the economy of the major European and Asian countries suffered a lot, but only the United States benefited from the war. Its economy grew rapidly, which formed the absolute advantages of industrial production and it also took up a dominant position in the area of international trade and finance. At the same time, because of the rapid growth in abroad investment, the United States became the world’s largest creditor country. The gold reserves of the United States had increased from $14.51 billion in 1938 to $20.08 billion in 1945, which accounted for about 59% of the total gold reserves in the world[2]. On the basis of enough economic power, the United States began to seek a way to establish an international monetary system, which was centered to the US dollar in order to establish its financial hegemony around the world. In July 1944, the Bretton Woods Conference adopted the file named International Monetary Fund Agreement and decided to establish the International Bank for Reconstruction and Development. So far, the Bretton Woods System was officially established.

In this system, it clearly stipulated the communication medium of each member country—The US dollar. The currency of each country was directly linked to gold, and the US dollar was the most significant among them. However, the system began to show some symptoms of collapse in the 1950s, and the decreasing economic power of the United States.
States gave birth to the shortage of equilibrium as for its economic development status, while the severe excess of dollars would directly affect the economic development of capitalism. Taking into the consideration of the outbreak of the crisis of US dollar, all of the above had a direct influence on the American economic system and placed the system in a state of turbulent and collapse. As we know from the historical data, the 7th crisis broke out in the United States in 1971, and there were 44 member countries withdrawn from the new economic policy, which led to the gradual collapse of the system.

There are many reasons for the collapse of the Bretton Woods System, among which the Triffin problem is the most significant one. In the 1960s, Professor Triffin put forward the Triffin plan in his book named Gold and Dollar Crisis, and formulated corresponding saving measures around the existing problems of the system. From the opinions of Professor Triffin’s viewpoints, the fact that the currency of each member country was directly linked to the US dollar would directly affect the international status of the US dollar around the world. It was helpful for the member countries to improve their international status and facilitate them to form a better currency reserve. However, through this way, a large amount of US dollars would flow out of the country, which would help member countries accumulate US dollars, on the contrary it would have a severe influence on the development of the United States economy. Thus in a long run, it would easily lead to the trade deficit of the US economy and impact the stability of the international core currency and it was difficult to fulfill the long-term core position. Only through the way of guaranteeing the position as a long-term trading nation for the United States, it could fully ensure the status of the dollar as the international core currency. However, these two statements were contradictory and also a paradox. In order to operate the Bretton Woods System normally, it was necessary to sufficiently ensure the stability of the US dollars. If the economy was in constant turmoil, it would be very difficult to stabilize the US dollars. Just because of the lack of balance of the economic development of the dollar currency, moreover, it was deeply influenced by the turbulent essences, all of the factors directly led to the collapse of the system.

Institutional construction is another important reason for the collapse of the system. In the former 10 years of the system operation, the overall operation situation was stable and well. This was mainly because the member countries were committed to the recovery of domestic economic interests after World War II, which could fulfill full play to the advantages of the system, but the system did not improve the development of economy, and each member country paid much attention to the economic effect produced by the operation of the system and cared little about the contradictions in it. No matter what kind of currency used when the country effected international payments, it would be affected by the dollar, so it would occupy the important position in the monetary system only through the way that fully guarantee the stability of the member countries to have a stable and stronger currency. In other words, there are sufficient holdings of the US dollar and gold, and also must ensure that the balance of payments surplus is more than that of output so as to absorb gold sufficiently. It can be seen that currency should be kept in its own country instead of being used as an international payment way. In order to give full play to the competitive advantages of all member countries in the international stage, currency must be put in the circulation of funds to provide sufficient conditions for the fulfillment of monetary balance of payments deficit. However, it is worth mentioning that once the financial currency deficit appears in one of these countries, it will lead to serious impact on the healthy and stable development of the country’s economy and then cause unnecessary economic fluctuations as a result. At that time, the corresponding other member countries would not view the currency as an significant method of international payment, not to mention the reserve currency.

2. The impact of Bretton Woods System on the United States

2.1 Benefits of the Bretton Woods System

2.1.1 Conducive to the expansion of the United States

In addition to making abroad direct investment as capital export with the US dollars, the United States can also use the US dollar to pay for its huge overseas military expenditures. In the former period after the post-war, the countries around the world was rushing to restore the economies that had been destroyed by the war. At that time, there was lack
In order to resist the Soviet Union’s penetration in Eastern Europe and strengthen its impact on Western Europe, the United States formulated the Marshall plan in June 1947. It was nominally to supply assistance for the renaissance of European countries, but in fact it was to take use of its economic power formed in the war to penetrate deeply and expand further in Western European countries. Its target was to control the Western European countries in the position of economy and politics, and at last make the Western European countries be the investment and sales market of the United States. At the same time, from the angle of global strategic interests, the United States converted its expansion direction to the Asia-Pacific region and began to export capital to some Asian countries, such as Japan and so on.

2.1.2 Assisting the United States to obtain huge seigniorage
The so-called seigniorage was originally a tax levied on the minting of gold, silver and other precious metals by Western European countries in the Middle Ages. Later, it refers to the profits achieved by governments through the issuance of currency. At present, the popularity of bank notes leads to lower cost to make coins and fulfills funds transferable by bank transfer without the demand of cash. The process of creating seigniorage is the process by which foreigners fulfill to hold US dollars. By issuing the US dollars, the United States can exchange the assets owned by foreigners. The consumption it enjoys has exceeded the amount of domestic goods, services and production quantity. There exists almost no cost in the process. The intermediate difference is the seigniorage of the United States. Nowadays, the majority of dollars issued by the U.S. central bank circulate in foreign countries, which can help the United States get huge benefits every year.

2.1.3 Conducive to raising for the United States
Because of the special status of the US dollar in the international stage, it can promote the United States to borrow around the world, but on the contrary, the repayment is not equal or even irresponsible. Because the United States can borrow from other countries calculated in US dollars, through the depreciation of the US dollar, it can help the United States reduce its own debt, and effectively stimulate its exports and improve its balance of payments.

2.2 Hidden dangers of the Bretton Woods System
2.2.1 Weakening the US economy, aggravating trade frictions, and accelerating its collapse
The fixed exchange rate system was built on the basis of American hegemony. With the weakness of its economic competitiveness, it became more and more inappropriate. Coupled with unbalance economic development of other countries and the continuous friction, it was difficult to maintain a fixed exchange rate, so the US dollar became the main currency to be sold by people. In 1972, the United States intervened the foreign exchange market with a large amount of gold reserves. Other capitalist countries put a large amount of their own currencies in the market so as to maintain the fixed exchange rate of the US dollar, which would easily bring a great burden to the United States and lead to further aggravation of inflation in other countries.

2.2.2 Frequent dollar crisis
With the economic recovery and higher competitive power of Western European countries, it gradually improved the international balance of payments to a certain extent. These countries began to use US dollars when they wanted to exchange for gold, and thus led to a large number of gold outflows and a great increase in debt. Under this circumstance, it was difficult for the United States to maintain the dollar in a fixed price of gold. The study has shown that the U.S. gold reserves were only about $12.1 billion in 1967, while the short-term external debt was already $33.1 billion, which left the hidden cause for the second outbreak of the dollar in 1968. Although the creation of Special Drawing Rights was created within capitalism, the United States still severely defended the system and tried its best to maintain the international status of the US dollar, even in this way, the crisis of US dollar surplus was still difficult to be properly resolved. In Western Europe, as a result of the inflow of a large amount of dollars, the Federal Republic of Germany had to close its foreign exchange market, and other countries also stopped buying dollars, which led to frequent crises of dollars⁵.
3. Influence on international relationships

The existence and change of the Bretton Woods System will directly affect international relationships. The system was established under the dominance of the United States, to a certain extent, it represents the interests of the United States. Its collapse is closely related to the economic development of the capitalist countries, and it will also be able to assist these countries to change their positions in the world.

First of all, this system can provide tools for the developed countries to exploit developing countries, which fully embodies the hegemony of the United States. In the pyramid monetary system set up by this system, the US dollar is at the top of the pyramid and owns absolute rights. As a result, the top layer can directly control the bottom layer, while the second layer can play an indirect control role over the first layer\(^6\).

Secondly, although it is to preserve the interests of developing countries, but it is liable to reflect the interests of developed countries. Through short-term loans, it can balance international payments, offer some assistance for all member countries. In this way, it will create a relatively free competition environment for each member, but the real power is the key to competition. Generally speaking, the developed countries have very strong strength, so they will acquire the corresponding interests, on the contrary, the developing countries will be poorer.

What is more, the system was established under the condition of the stage when the United States was powerful. To maintain the hegemony of the US dollar, there was a relationship of contradiction when it established the corresponding systems, which was the consolidation and maintenance of the hegemonism for the United States. But after running for a period of time, it would have strong restriction effects on the U.S. economy development, which could lead to a certain strike on American hegemony. So with the collapse of the system, the international status of the US dollar was also gradually declining\(^7\).

4. Conclusion

To sum up, this system can help the United States to maintain its hegemony after the end of World War II, and to some extent, it will have a serious influence on the evolution of the international pattern after World War II.

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