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International Political Economy

Martin Daunton

1 Introduction: International Political Economy and Policy Trade-Offs

International political economy deals with the relationships between countries in trade, money, capital and migration which also entails the relationship within each country between domestic and international interests. Were they in tension, so that pursuit of a domestic agenda led at an extreme to a zero-sum game of capturing trade from rivals, to a strategy of import substituting industrialisation, or at least to protection against foreign goods to preserve domestic employment? Or was priority given to international trade with constraints on economic nationalism in order to gain from the laws of comparative advantage? The balance between these different approaches both shifted over time and varied between countries at any one point. A major task in international political economy is to understand the reasons for these variations in time and space. The analysis focusses on the ways in which different states responded to the policy trade-offs—which is not to say that there were self-evident national interests that were expressed by politicians. Of course, politicians and their officials had their differing views of what might constitute the national interest, shaped by their own ideologies and by the ideas of leading economists, as well as by a sense of what

M. Daunton (✉)
University of Cambridge, Cambridge, UK
e-mail: mjd42@cam.ac.uk

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might appeal to the electorate or to powerful economic interests. Politicians and the state were not simply reflecting the views of different economic interest groups, for these groups were defined through rhetorical and cultural processes as well as by self-evident material interests.

Dani Rodrik offers a starting point for thinking about these issues. He stresses the difference between, on the one hand, national economies with their complex regulatory and political institutions and, on the other hand, global markets that are only 'weakly embedded', suffering from weak governance which leaves them 'prone to instability, inefficiency, and weak popular legitimacy'. National economies may adopt different preferences about institutions and regulations, which leads to a 'political trilemma of the world economy', a need to choose two of democracy, national determination and economic globalisation. It is not possible to pursue all three at the same time: 'If we want to push globalization further, we have to give up either the nation state or domestic politics. If we want to maintain and deepen democracy, we have to choose between the nation state and international economic integration. And if we want to keep the nation state and self-determination, we have to choose between deepening democracy and deepening globalization'. A choice therefore had to be made to prevent the pursuit of globalisation threatening domestic policies, or the pursuit of domestic policies overturning globalisation.

This trade-off varied over time and was difficult to maintain, for it was always challenged by shifting forces in both domestic politics and international relations. In the 1930s, globalisation was undermined by the pursuit of national interests. A balance was struck much more successfully after 1945 when 'shallow multilateralism' allowed a reduction of trade barriers and financial stability, combined with domestic economic policies for employment and welfare. The recovery of the world economy was combined with the creation of different versions of the welfare state that created a balance between international and domestic considerations. In Rodrik's view, globalisation has recently suffered from 'hyper-globalisation' with greater capital movements and deeper economic integration that are less compatible with democracy and national determination of domestic economic policies. He argued that 'reempowering national democracies will … place the world economy on a safer, healthier footing. A thin layer of international rules that leaves substantial room for maneuver by national governments is a *better* globalization' (Rodrik 2011, pp. xvi–xix).

At this point, a further trilemma arises. International economic policy could rest on fixed or floating exchange rates, on free or controlled movements of capital and on active or passive domestic monetary policy. Once again, a

choice had to be made between these three variables which had major implications for the precise nature of globalisation and its relationship with domestic politics.

A central feature of the globalised world economy before the First World War was fixed exchange rates on the gold standard in association with open capital markets. This choice ruled out an active domestic monetary policy. A country might wish to raise interest rates and tighten monetary policy for domestic reasons in order to stop inflationary pressures or over-heating of the economy, but free movement of capital allowed funds to flow into the country in order to take advantage of high interest rates, so leading to an appreciation of the exchange rate. Since the country was committed to fixed exchange rates, the central bank had to intervene to hold down the value of the currency. Hence, monetary contraction was reversed, the domestic money stock rose, and interest rates returned to their initial, lower level. The argument runs the opposite way if a country wished to reduce interest rates in order to simulate the economy and boost employment. In this case, monetary supply increased and interest rates dropped; capital now flowed out of the country to seek a higher return elsewhere and the balance of payments weakened. Any benefit to the domestic economy from lower interest rates was countermanded by the outflow of capital. Instead of stimulating the domestic economy, lower interest rates encouraged capital exports, and low interest rates were not sustained because of the priority given to maintaining the fixed exchange rate. The outflow of capital resulted in depreciation of the exchange rate, and the central bank had to intervene in order to maintain the fixed parity. Monetary expansion was reversed and interest rates returned to the initial level.

This particular choice in the trilemma changed in the interwar period. After an initial attempt to restore the gold standard, many countries abandoned the effort and adopted floating exchange rates with capital controls and an active domestic monetary policy. Globalisation went into decline at the expense of economic nationalism. Let us assume that interest rates were reduced for domestic reasons, to stimulate the economy and increase employment. Capital would flow out of the country and the exchange rate would depreciate. The exchange rate could be allowed to float downwards which led to increased competitiveness in world markets, always provided that any outflow of capital did not become so serious that it harmed the domestic economy. Here was the policy adopted by the British government in 1931 when it came off gold, allowed the pound to drop in value, so boosting exports and discouraging imports, and permitting low interests to stimulate the economy. President Roosevelt followed a similar approach

when he came to office in 1933—though other major economies such as Germany did not take the same line and suffered from slower recovery and a need for extreme measures to protect its economy (Mundell 1960, 1963; Fleming 1962; Obstfeld and Taylor 2004, pp. 29–33).

The Bretton Woods regime reached another trade-off after the Second World War. Exchange rates were fixed, but with the possibility of realignment if too far out of line with economic reality. A currency could be devalued to avoid deflating the domestic economy as occurred under the gold standard. It was possible to pursue domestic monetary policies by controlling international movements of capital: a country could reduce interest rates in order to boost its domestic economy without fearing an outflow of capital that would threaten the exchange rate. Such a trade-off meant that national determination was combined with a recovery of globalisation, turning away from the economic nationalism of the 1930s to allow countries to pursue their own domestic policies and restore multilateralism.

The trade-off shifted again by the 1970s as the Bretton Woods regime fell apart. Exchange rates were allowed to float and capital became more free to move between countries, returning to the levels last experienced before the First World War. In that earlier period, capital movements were combined with fixed exchanges so that countries could not pursue their own domestic monetary policies. From the 1970s, capital movements were combined with floating exchanges which meant that governments did not need to use monetary policy to defend their currency. By the turn of the twentieth and twenty-first centuries, the balance was shifting yet again, and a new phase of 'hyper-globalisation' was threatening national determination—with a democratic backlash expressed in the British vote to leave the European Union and the election of President Trump in the USA to 'take back control'. The issue here was not only the trade-off between exchange rates, capital movements and domestic monetary policies, for two other elements need to be added to the equation: trade and migration.

The trilemma may be extended to an 'inconsistent quartet' by adding free trade versus protection and to an 'incompatible quintet' by inserting labour mobility versus restrictions. Again, the trade-offs between these variables varied between countries and over time. Table 1 indicates that the level of tariffs and engagement in international trade varied widely between four countries committed to fixed exchange rates in 1913, with Britain and the USA at the extremes. Before 1914, the British government's choice within the 'inconsistent quartet' was free trade, capital mobility and fixed exchanges at the expense of a loss of autonomy in domestic monetary policy. In the USA, higher tariffs were combined with fixed exchanges, but with more autonomy in monetary

Table 1 Import duties as a percentage of total imports and total trade as a percentage of GNP, 1913 (*Source* Estevadeordal 1997, p. 91)

	Import duties as % of total imports	Total trade as % of GNP
France	8.7	39
Germany	7.9	40
UK	5.6	48
USA	21.4	11

policy which was reflected in the decentralised structure of the Federal Reserve System established in 1913 that gave more power to the regional Federal Reserve Banks, with their boards reflecting local business interests.

The 'incompatible quintet' inserts the labour market and migration into the equation. The successful maintenance of fixed exchange rates is often taken to mean flexible wages in order to adjust the balance of payments. A deficit in the balance of payments could not be corrected by allowing the exchange rate to fall so that exports were more competitive and imports more expensive. Consequently, costs had to be reduced by cutting wages (or increasing productivity to reduce unit labour costs). If wages were rigid or 'sticky' in a downward direction and productivity did not increase, fixed exchange rates came under pressure. This trade-off caused domestic political problems when workers resisted the impact of deflationary policies on their wages and employment. One result might be protection to stop the importation of cheaper foreign goods. Another possibility was international migration which was, to some extent, an alternative to changes in the exchange rate, allowing an escape route when wages and costs were driven down in order to be more competitive. Wages are more likely to be 'sticky' when immigration is limited and to come under pressure when it is high. Floating rates could merely allow trade unions to demand higher wages and employers to accept their requests in the knowledge that the exchange rate could take the strain and provide an easy solution (as in Britain)—a danger that could be avoided by a tight income policy, a rise in unemployment to weaken labour's bargaining power or an increase in immigration.

2 The Exchange Rate Trade-Off: Why Were Exchange Rates Fixed or Floating?

Dealing with all of these variables across time and between countries is a formidable task that cannot be achieved in a comprehensive way in one chapter. The aim is to suggest some of the ways in which the trade-offs can

Table 2 Policy trade-offs between domestic monetary policy, capital mobility and fixed exchanges in Britain, c.1870–1990 (*Source* Adapted from Obstfeld and Taylor 2004, p. 40)

	Fixed exchanges	Capital mobility	Active domestic monetary policies
Gold standard			
to 1913	Yes	Yes	No
1925–1931	Yes	Less	Tentatively
Off gold			
1931–1939	No	No	Yes
Bretton Woods			
to 1973	Yes	No	Yes
Float from			
1974	No	Yes	Yes

be analysed and understood through some case studies and illustrations. I start by considering the choice of exchange rates from which so many other things followed: were rates fixed or did they float? (Table 2).

The gold standard was reintroduced by Britain in 1821 after a period of suspension during and after the French Revolutionary and Napoleonic Wars. Its widespread adoption by other countries started with Germany in 1872, followed by the Netherlands in 1875, Belgium in 1878, France in 1878, the USA in 1879, Italy in 1884, Japan and Russia in 1897. Meissner's statistical test of the various economic variables that might lead to the adoption of gold finds that the crucial factor was the level of trade with other gold standard countries, not so much because the gold standard reduced the risks of exchange rate volatility between two different monetary regimes, than that a single standard reduced the transaction costs of trade. Gold was adopted in those countries with the largest trade with the gold bloc relative to their GNP, and the potential savings rose as the size of the bloc increased. Countries on the gold standard traded almost 30% more among themselves than with non-gold countries, and global trade would have been 20% lower between 1880 and 1910 without its widespread adoption. Hence, the decision to adopt the gold standard was encouraged by Britain's early adherence to gold, and its financial and trading significance in the mid-nineteenth century (Meissner 2005; López-Córdova and Meissner 2003). The French government realised this point in 1867, when it saw the virtues of moving from its current dual silver and gold standard. The rationale for the choice is apparent in a survey of French opinion in 1868: merchants trading with Britain supported a gold standard, whereas eastern and southern France

trading with silver regions in Germany, Austro-Hungary and Russia favoured silver (Flandreau 2004).

The gold standard also allowed preferential access to international capital by reducing exchange rate risks for lenders, offering a 'good housekeeping seal of approval'. Exchange rate risks for lenders were reduced, so that the government was able to borrow on international capital markets on more favourable terms (Bordo and Rockoff 1996). The Japanese adoption of the gold standard, for example, was encouraged by this consideration (Sussman and Yafeh 2000, pp. 442–443). Adoption was delayed where banks were unregulated and fiscal policies were weak, for in these circumstances gold might flee in search of safety elsewhere, and maintenance of a fixed exchange rate would be difficult. A successful switch from paper money or silver to gold therefore depended on political reform to control government debt and ensure stable banking. Latecomers to the gold standard needed time to introduce these fiscal and banking reforms (Meissner 2005). By contrast, Britain had a reputation for fiscal prudence and stable banking as a result of the reintroduction of the income tax in 1842 and the Bank Charter Act of 1844. British state finances were secure and stable, its national debt was falling, and government bonds had a high reputation which allowed the government to borrow on favourable terms (Daunton 2001; Ferguson 1998, pp. 127, 131). Membership of the gold standard was part and parcel of the wider fiscal constitution of nineteenth-century Britain.

Did the adoption of the gold standard entail a sacrifice of domestic interests and national determination to the pursuit of economic globalisation? The gold standard is often portrayed as in the interest of the City of London and its counterparts in international finance in Frankfurt and Paris (Green 1988). Eichengreen takes a similar view that a government's credible commitment to gold and international cooperation was possible because those who stood to lose from fixed exchanges and to gain from active monetary policies lacked political voice until after the First World War. In his view, workers suffered as a result of the priority given to international monetary stability which meant that their wages had to adjust to the exchange rate, and blocked the use of interest rates to create domestic economic stability. He implies that organised workers were hostile to the gold standard and internationalism, but could not make their voice heard; survival of the gold standard and the credibility of the commitment before 1914 depended on the ability of the state to ignore those who suffered from its domestic economic impact. Despite the rise of trade unions and the extension of the franchise to skilled workers, and a growing realisation that high interest rates harmed trade

and investment, he suggests that bankers had no difficulty in giving priority to external over domestic targets. Furthermore, Eichengreen argues that opposition to the trade-off between domestic and international concerns was ineffective before 1914 because economists had limited theoretical understanding of the link between international monetary policy, high interest rates and domestic stability. According to Eichengreen, workers and industrialists could not make a coherent link between policies designed to protect the gold standard and unemployment or depression. If he is right, then it follows that resistance to the gold standard between the wars arose both from the extension of the franchise to all adult men which gave workers political voice and from the development of economic theories making a link between the pursuit of international economic policies and their own welfare. Furthermore, he argues that commitment to gold was international and not just national, and that central bank cooperation was possible before 1914 but not after. In his opinion, the gold standard survived up to the First World War because central bankers were able to cooperate, whereas between the wars they could not (Eichengreen 1992, pp. xi, 5–12).

These explanations are open to objections. In the first place, did acceptance of the gold standard in Britain and elsewhere arise from a lack of voice prior to 1914 which prevented the expression of opposition to gold? More plausibly, many workers supported or at least tolerated the gold standard as a natural element in the institutional structure of Britain's political economy. Many workers had voice or representation as a result of franchise extensions in 1867 and 1884, and what mattered was not their silence but the fact that they had little reason to oppose the gold standard. The case for the gold standard was much wider than the self-interest of the City, for organised workers gained from rising real wages. It was 'an essential part of the "social contract" between the working class and the State', resulting in lower prices and rising real wages rather than a loss of jobs (Howe 1990, pp. 389–390). It was easy to assume that the gold standard led to improvements in welfare, economic stability and growth rather than a lack of autonomy in setting interest rates, a sacrifice of domestic prosperity, high unemployment and depression. When unemployment emerged as a political concern from the 1880s, monetary issues were largely irrelevant to discussion of its causes which were placed predominantly in the structure of the labour market or the distribution of income (Harris 1972).

The gold standard was firmly embedded in the political culture of Britain between 1850 and 1914, attracting support beyond the City. The gold standard was automatic and therefore offered freedom from manipulation by financiers and speculators which was possible in a system with

more discretion. It was considered to be 'knave proof' (Grigg 1948, p. 183). Linking the creation of money to gold was a way of purging the financial system of an over-expansion of credit that produced financial crises, removing the corrupting power of money over business and over the state (Hilton 1977, 1988). Gold was linked with peace and civilisation, a symbol of economic modernity and sophistication appropriate for advanced economies. W.S. Jevons used an evolutionary language of progress in order to criticise American advocates of a double or bimetallic standard who 'would be stepping back from the gold age into the silver age. This seems to me about as wise as if the men of the bronze age had solemnly decided to reject bronze, and to go back into the stone age'. He urged the USA not to turn away from gold to silver which should be left 'to those Eastern nations who are too poor and ignorant to employ gold' (Daunton 2006, p. 23; Jevons 1875, p. 149; Jevons 1884, pp. 309, 316).

In fact, many Americans viewed the gold standard less as a symbol of modernity than as a tool for exploitation. Shortages of gold in the third quarter of the nineteenth century meant that prices fell, so increasing the burden on debtors (above all farmers) and fuelling demands to remonetise silver. William Jennings Bryan, the presidential candidate for the People's Party and Democrats, famously claimed that America was being crucified on a cross of gold, but he was defeated in 1896. Prices started to rise modestly, and the demand for monetising silver faded away until the onset of serious price deflation in the early 1930s. There were also problems in countries that remained on silver, such as India. The decline in the value of the rupee affected both Britain and India: it meant that British exports to India (the only area with which it had a trade surplus) became more expensive, and it meant that India's costs of paying the 'home charges'—payments to Britain for administration and defence—and debt payments mounted. The Indian government complained that the declining value of silver relative to gold was causing unrest and fuelling nationalism. India was losing income because two-thirds of its trade was with gold-based countries. Furthermore, the burden of the 'home charges' was rising, with a consequent need to cut expenditure or increase taxes (Cain and Hopkins 1993, pp. 341–342, 344–347). The choice of standard therefore had major domestic and international consequences and must be carefully located in the politics of each country.

What of Eichengreen's claim that survival of the gold standard rested on cooperation between central banks? Flandreau reads the evidence in a very different way and argues that 'central bank co-operation was probably not decisive in the operation of the gold standard'. He argues that adoption of gold was not preordained but 'an accident of history', arising from a 'massive

co-ordination failure'. The timing was determined by *force majeure* rather than negotiation. The problem for countries contemplating adopting gold was how to dispose of their silver. France was considering a shift to gold in 1867, but was beaten to the adoption of the new standard by Germany. Prussian victory over France in 1870 provided a means for the new, unified Reich to dispose of silver and create a new gold currency for the new state. Germany's indemnity of 5 billion francs from France secured gold; its silver was then sent to France to take advantage of its double standard. In order to restrict German silver sales, the French government limited silver coinage in 1873 to prevent Germany's adoption of gold. The attempt failed and reinforced the shift to gold. As Flandreau remarks, 'the emergence of the gold standard was a blatant failure of international co-operation'. His analysis of the subsequent behaviour of central banks shows that cooperation was 'exceptional, never reciprocal, and always failed to institutionalize', and their approach may be understood as a mixture of 'hatred, neglect and indifference'. The banks only helped each other if it was in their own interest and not out of concern for the system as a whole. The conflicts of the 1870s reappeared in the run-up to the First World War as central bankers became part of the armaments race. Inter-bank cooperation was less significant than the fact that politicians in each country pursued their own independent policies to secure a war chest of gold and to secure the advantage of belonging to the major trade bloc of the world. Contrary to Eichengreen's claims of cooperation prior to 1914, 'most of the evils at work during the inter-war years (competition among nations to attract gold, inability to enforce a co-ordinated outcome, neglect of the international effects of national monetary policies, and the Franco-German rivalry) were already operating during the 1870s' (Einaudi 2001; Flandreau 1996, 1997, 2004).

Indeed, successful operation of the gold standard depended less on cooperation between the 'core' countries and more on the ability of the core economies to use the periphery (such as India), if necessary by coercion. Gold-based economies traded on a large scale with non-gold economies with more flexible monetary regimes, based on silver or inconvertible paper: about two-thirds of the merchandise trade of the European core economies was with such countries, and about 40% of the USA's trade. Changes in the nominal exchange rate on the periphery led to considerable fluctuations in the real effective exchange rate, both because of variations in the price of silver relative to gold and also because of monetary policy in the core and movements of capital. When high levels of capital exports led to a fall in reserves, central banks in the core increased interest rates, so checking capital exports to the periphery and forcing the periphery to adjust parities to

resolve the ensuing balance of payments problem. These changes in parities affected trade balances, so allowing adjustments in international payments. A reduction in exchange rates in the periphery in response to cuts in capital led to falling import prices in the core countries; when capital exports from the core were high, rising activity in the periphery reduced the impact of weaker investment in the core. In the words of Catao and Solomou, 'exchange rate flexibility in the periphery seems to help explain a key puzzle of the classical gold standard …, namely, how significant relative price adjustments were accomplished without jeopardizing the gold peg in the absence of massive reserve accumulation by the core central banks' (Flandreau 1997, pp. 760–761; Catao and Solomou 2005, p. 1272).

In Britain, free trade and the gold standard survived as inseparable twins up to the First World War. The pattern differed in other countries where maintenance of the gold standard came at the cost of partial surrender to protectionism. Adherence to gold led to an increase in world trade, from which we can deduce that membership of the gold bloc was likely to be supported by interests and sectors committed to external trade. Yet a number of countries on the gold standard adopted protectionist policies. This outcome appeared contradictory to Britain which saw gold and free trade as joint props of a liberal international economy, but it reflects the complex trade-offs within different societies. Countries adopting gold in the 1870s made the decision without considering trade policy and subsequently compensated losers by introducing tariffs, as in Germany.

The gold standard was suspended during the First World War, but there was a general desire to return in the 1920s. But circumstance had changed, and gold was abandoned by Britain in 1931 and the USA in 1933. How is this change in the trade-off to be explained? Eichengreen argues that the ability of bankers to work together after the war was limited by a loss of discretion and independence, for governments were scarred by the experience of inflation or hyperinflation in the early 1920s. In order to prevent a repeat of the devastating consequences of inflation on social relations, political legitimacy and economic stability, central bankers in many countries were obliged to abide by various rules imposed by their national governments, so removing their ability to work together and making the collapse of the gold standard more likely (Eichengreen 1987, pp. 9–10). He is right that the discretion of bankers was reduced in some countries, but as we have seen the gold standard did not rest on central bank cooperation. Rather, we can locate domestic political reasons why support for the gold standard was reduced, so that the trade-off on which it rested became less stable.

Britain had been at the heart of the pre-1914 gold standard and returned to gold in 1925. Remaining on gold was now much more of a challenge. Inflation in Britain during and after the war meant that the pre-war parity of the pound sterling was too high against the dollar and other currencies by between 5 and 20% in 1925 compared with 1913, and the decision to return to the gold standard exacerbated the problems in export markets for Britain's declining old staple industries. This over-valuation entailed deflation, attempts to cut wages and high interest rates to hold down prices (Redmond 1984; Matthews 1986; Broadberry 1990). The economic shock of the war had a long-term impact on equilibrium. Before 1914, unemployment was around 4.5% and casual under-employment was in decline; after the war, the level of unemployment was never less than 10% (Solomou 1996, pp. 44–45, 53). The changed attitude to the gold standard and its need for higher interest rates was not the result of workers securing voice to express a long-standing grievance, but rather of a change in economic conditions which created an objective justification for growing hostility to the previous trade-off between international and domestic policies. The link between fixed exchange rates and unemployment and the need to defend wage rates were much more apparent than before 1914. Further, high interest rates to deflate the economy and return to gold affected the cost of servicing the national debt incurred to fight the war. As prices fell, so the real burden of debts rose, and Winston Churchill—who was responsible for the decision to return to gold—saw that taxes and the *rentier* class 'lie like a vast wet blanket across the whole process of creating new wealth by new enterprise'. Between 1919 and 1931, the government had to balance the use of interest rates to return to and maintain the gold standard against the impact on its finances and the politics of debt redemption (Daunton 1996; Daunton 2002, p. 123). When gold was abandoned in 1931, interest rates could obviously be used in a much more active way to hold down the exchange rate, to simulate domestic recovery and to convert the national debt to a lower interest rate (Nevin 1955).

In the absence of variation in the exchange rate, international competitiveness and adjusting the balance of payments were only possible by reducing costs. The successful operation of the gold standard therefore depended on flexibility in costs and above all wages. Contemporary economists generally assumed that wages were more sticky after the First World War, and that this failure of adjustment contributed to higher costs, unemployment and the collapse of the gold standard. At the time of the return to gold in 1925, Keynes warned of the consequences of attempting to adjust wages and costs to the international situation by 'the theory of the economic juggernaut … that our vast machine should crash along, with regard only to its equilibrium

as a whole, and without attention to the chance consequences of the journey to individual groups'. This theory held that unemployment would force workers to 'accept the necessary reduction of money wages under the pressure of hard facts'. Keynes rejected this approach as 'an essential emblem and idol of those who sit in the top tier of the machine'. Change was needed, for 'in modern conditions wages in this country are, for various reasons, so rigid over short periods, that it is impracticable to adjust them to the ebb and flow of international gold-credit, and I would deliberately utilize fluctuations in the exchange as the shock-absorber' (Keynes 1925, pp. 218, 224, 233–234; Skidelsky 1992, p. 205).

Why were wages sticky? Empirical studies of 10 industrial countries in 1935 by Eichengreen and Sachs and of 22 countries in 1931–1936 by Bernanke and Carey both indicate that wages were sticky despite the monetary shock (Bernanke and Carey 1996; Eichengreen and Sachs 1985). The reasons remain puzzling. Eichengreen suggests that there was a coordination problem. He points out that certain variables were fixed in nominal terms for some time—mortgages, rents, bonds—and 'claimants to these sources of income—rentiers, capitalists, and workers—each would have accepted a reduction in their incomes had they been assured that others were prepared to do the same. Without a mechanism to coordinate their actions, no one group was prepared to be the first to offer concession' (Eichengreen 1992, p. 16). But British bondholders *did* accept a reduction in their interest in the conversion of 1932—a change which was only possible because interest rates in general were held down, which was in turn only possible as a result of abandoning the gold standard. Was it rather that wages were more inflexible because of welfare benefits? (Robbins 1934, pp. 60–61; Benjamin and Kochin 1979). In fact there is little evidence that male heads of household opted for benefits in preference to work (Eichengreen 1987). More realistically, the nature of production institutions limited flexibility with the rise of collective agreements. Adjustment of wages to changes in prices or prosperity no longer rested on the individual action of employers, for 'the process of general wage-changes has … been constitutionalised', so preventing 'nibbling' at wages by 'hard-pressed or unscrupulous employers' and set rates by the larger and better organised firms. The influence of unemployment relief was not a refusal of work, but rather indirect in making union leaders less inclined to take account of unemployment (Clay 1929). The politics were different in countries without tax-funded welfare and with weaker collective bargaining.

Britain abandoned gold in 1931 and the USA followed in 1933 (Roosevelt 1933b). As we noted, the gold standard faced more criticism

in late nineteenth-century America than in Britain, and falling agricultural prices after the war led to revived demands for monetisation of silver to increase the monetary supply. Roosevelt had a long-standing interest in monetary issues and was attracted by the theories of William Trufant Foster and Waddill Catchings who argued in favour of monetary policy and public spending in response to recession. They stressed the 'dilemma of thrift': savings disrupted the flow of money, extracting it from circulation. The solution was to increase the supply of money in order to compensate for savings and to allow consumers to purchase the larger output (Barber 1985, pp. 55–58). Roosevelt was also interested in the ideas of Irving Fisher, an economist at Yale, who stressed the role of money in stabilising the economy. Central bankers should provide sufficient money to prevent prices falling which would trigger a vicious circle of debt-deflation: as prices and wages fell, people were less able to pay their debt, cutting other spending, leading to distress selling and eventually to default which could undermine the financial system. Fisher argued that this process explained the depth of the depression. If the Federal Reserve had reflated prices back to the average level at which debt had been contracted, the debt-deflation cycle would have been broken. Fisher argued that the gold standard made it impossible to maintain constant purchasing power at home through an active use of monetary policy; it should therefore be abandoned in favour of floating exchange rates (Barber 1985, pp. 58–60, 160–162; Fisher 1932, 1933). Roosevelt was willing to give the new monetary policy a try, rejecting the 'old fetishes of so-called international bankers' and 'lifting the price level to restore a more equitable relationship between debtors and creditors' (Rauchway 2015, pp. 19, 44, 54, 71; Toniolo 2005, pp. 145–46; Clavin 2013, pp. 118–119; FRUS 1933, I, p. 686).

Keynes was delighted by Roosevelt's abandonment of gold with the opportunity to create 'the managed currency of the future' rather than following Europeans who 'cling fanatically to their gold perches' and 'see no virtue in a rising price level … until prices have risen to a level appropriate to the existing debts and other obligations fixed in terms of money' (Ahamed 2009, pp. 465–471; Rauchway 2015, p. 71). A number of European countries formed a gold bloc—and Germany, which was not a member, in particular clung to gold (Toniolo 2005, pp. 146–147). German exports were hit by the over-valuation of the Reichsmark as a result of the devaluation of sterling in 1931 and the dollar in 1933. The obvious solution was to devalue the Reichsmark, but Hitler and his economics minister, Hjalmar Schacht, refused. German politicians were scarred by hyperinflation in the early 1920s, and they feared that devaluation would reignite inflation by increasing the costs of imported food and materials.

Devaluation of the Reichsmark would also affect the cost of servicing the debt. The costs of Germany's interest payments to Britain and America were reduced by devaluation of sterling and the dollar, and Schacht had no wish to increase the burden by devaluing the Reichsmark at a time when the weak balance of payments made debt service difficult. His reasoning was weak, for devaluation would make German exports more competitive and so increase production and employment; it would improve the balance of payments so that servicing of the debt would become easier. But Schacht could not afford to take a gamble: the balance of payments would take some time to respond, whereas his problems were immediate and pressing. In any case, Schacht followed his fellow central bankers in a commitment to monetary discipline which he learned from his experience in stabilising the Reichsmark after hyperinflation. The choice of international monetary regime therefore reflected domestic politics and the strength of economic arguments in favour of gold or floating (Tooze 2006; Eichengreen and Uzan 1990).

Most orthodox economists and bankers disagreed with Roosevelt. Central bankers doubted Fisher's view that the quantity of money so directly affected prices, pointing to other factors such as harvests and technological change. Edwin Kemmerer, the 'money doctor' and staunch supporter of gold, felt that the real issue was not the quantity of money, for there were sufficient currency and credit. Rather, a loss of confidence by businessmen led to a reduction in the velocity of circulation of money so that prices fell. The solution was to increase the velocity of circulation by creating business confidence by remaining loyal to gold, sound money and fiscal responsibility (Barber 1985, pp. 157–160). But Roosevelt had other domestic political concerns. George Warren, an adviser to Roosevelt and advocate of higher prices, returned from a visit to Europe convinced that it was 'a choice between a rise in prices or a rise in dictators'. Hitler was the product of deflation that undermined domestic institutions; by contrast, the British had successfully raised prices by devaluing. Politicians from the cotton south came to the same view that prices needed to rise, and the populist campaign of the late nineteenth century had returned (Rauchway 2015, p. 80).

In January 1934, Roosevelt abandoned his policy of manipulating the price of gold which was stabilised at $35 an ounce by the Gold Reserve Act or 59.06% of its pre-1933 gold content. Although monetary policy was now less flexible, Roosevelt saw that he needed to control inflationists—such as Warren—who wanted to continue devaluation (Rauchway 2015, Chapter 5; Ahamed 2009, pp. 471–473). Could stabilisation provide the basis for international cooperation? In 1934, Harry Dexter White joined the Treasury and recommended a managed currency, based on a stable value for the dollar

that could be changed if circumstances dictated so that there was still the possibility of an independent domestic monetary policy. He realised that international cooperation was needed in order to coordinate changes in the value of currencies (Rauchway 2015, pp. 101–108).

Currency stabilisation became feasible when France considered devaluation on condition that the dollar and sterling did not embark on further depreciation in a currency war. In June 1936, the Popular Front government of Leon Blum came to power, with an ambitious programme for domestic recovery to be achieved without devaluation. Predictably the franc soon came under heavy pressure as a result of alarm at the alliance of socialists and Communists, and serious social unrest caused by deflation. The only way that the gold standard could be preserved was by adopting exchange controls as in Germany—a precedent that was not attractive. Devaluation would not help, for the pound would follow and so disrupt the international monetary system. The American administration saw an opportunity. The French would be able to devalue if the Americans and British agreed not to follow, so avoiding disaster in France and bringing about stabilisation between the three countries. For domestic political reasons, the French government wanted to avoid the impression that they were being forced into unilateral devaluation and abandonment of gold by presenting it as an achievement to end currency warfare and create international cooperation. In September 1936, a tripartite agreement was reached, an achievement that constrained the ultimate aim of the French to return to the gold standard which was not acceptable to the British and Americans who did not wish to surrender domestic autonomy (Clarke 1977; Bordo et al. 1994, pp. 3–6).

Walter Lippman welcomed the agreement as a way to 'feel our way to a sound currency for the world as a whole'. He pointed out that the gold standard created stability of currencies abroad but led to fluctuations in purchasing power at home. On the other hand, managed currencies without international cooperation led to stability at home but uncertainty abroad. The virtues of the tripartite agreement were that it created stability at home *and* abroad (Rauchway 2015, pp. 122–123; Toniolo 2005, pp. 175–182). Here, it seemed, was a way of reconciling the needs of the international and domestic economy, and ensuring that national self-interest did not destroy the general good. Secretary of the Treasury Henry Morgenthau felt that stabilisation 'represents a divorcement of the control of the foreign exchange market from the few individual international speculators. The responsible governments of the people will now cooperate to assure a minimum exchange fluctuation. Businessmen with merchandise to sell abroad or businessmen who are importing merchandise, will be free

to operate through their respective banks in regular and normal exchange operations' (Blum 1959, pp. 178–181). Stabilisation created a balance between domestic and international interests, and removed the power of Wall Street and the City of London—precisely his ambition at Bretton Woods in 1944.

Here was a motivation for the Bretton Woods agreement. Ragnar Nurkse captured the perception of the problem that 'there was a growing tendency during the interwar period to make international monetary policy conform to domestic social and economic policy and not the other way round. Yet the world was still economically interdependent; and an international currency mechanism for the multilateral exchange of goods and services, instead of primitive bilateral barter, was still a fundamental necessity for the great majority of countries. The problem was to find a system of international currency relations compatible with the requirements of domestic stability' (Nurkse 1944, p. 230). The Bretton Woods agreement struck a balance between international agreement and national autonomy. The dollar was pegged to gold at $35 an ounce, and other currencies were then pegged to the dollar, within a band of 1% either side of par. Unlike the gold standard, countries could change their rate by up to 10%, and the International Monetary Fund would accept a larger change to deal with a 'fundamental disequilibrium', with no objections on grounds of domestic policies. As Lippmann pointed out, 'none of the great powers is willing to sacrifice the freedom of its internal policy' and there was now 'almost unlimited domestic freedom and diversity at the expense of international conformity and stability' (Lippmann 1944).

The ability to pursue an active domestic monetary policy was guaranteed by the right to control capital movements. Keynes argued that 'central control of capital movements, both inward and outward, should be a permanent feature of the post-war system', as an essential tool for an active management of the domestic economy, allowing a country to 'have the appropriate rate of interest without reference to the rates prevailing elsewhere in the world'. The Bretton Woods agreement 'accords to every member government the explicit right to control all capital movements. What used to be a heresy is now endorsed as orthodox' (Keynes 1980, pp. 48–49, 52–53, 148–149). Harry Dexter White agreed that countries should block flows of capital that were devices for the rich to evade 'new taxes or burdens of social legislation which led to currency disturbances' (Steil 2013, pp. 134–135). Keynes argued that deflation and unemployment to maintain a fixed exchange rate were ruled out, so that the economic juggernaut of the gold standard would no longer crush the British people under its wheels (Keynes 1944, pp. 12, 16–18).

In any case, currencies were not convertible until 1958 which meant that international flows of capital were not large for many years.

The Bretton Woods regime was based on pegged exchange rates with a degree of flexibility that was designed to avoid the perils of both the gold standard and competitive devaluation, so allowing stable exchanges for the restoration of an international economy, alongside an active domestic monetary policy. Problems soon emerged. Peter Peterson, President Nixon's assistant for international economic affairs, pointed out in 1971 that 'Changes in exchange rates were seen as painful evidence of the failure of political and economic policies. Exchange rate changes were postponed. As a result, the realignments needed became larger, more disruptive internally, and therefore postponed even longer'. Exchange rates were kept at values that were out of line with economic fundamentals, so leading to speculation that unrealistic parities would not survive. Devaluation was made reluctantly in a situation of crisis, with a large adjustment. The fixed but variable exchange rate regime was not working and was creating the instability which the Bretton Woods system was designed to prevent. In the absence of devaluation, a balance of payments deficit could be removed by deflation of the domestic economy which was not politically feasible—so leading to alternative solutions of capital controls or trade barriers that threatened to undermine a multilateral world economy (Peterson 1971, pp. 16–17).

The system posed particular problems for the dollar. It was pegged to gold, so that all other currencies could devalue against the dollar, whereas the dollar could only devalue against gold. No one in 1944 contemplated a future in which the dollar would be weak—and equally, they did not contemplate a situation in which other currencies would be strong so that no conditions were laid down for revaluation. These two omissions were to haunt the fund in the 1960s when the German Deutschmark and Japanese Yen were undervalued, and the dollar faced a balance of payments deficit.

Neither had the Bretton Woods agreement accepted Keynes's proposal for a form of supernational bank money. In 1942, Keynes complained that 'the volume of international currency is not adjusted to need, but remains as before mainly dependent on the volume of gold mining and the policy of those countries which already have large gold reserves' (Keynes 1942, p. 160). Liquidity creation remained a problem after the war, when the economic dominance of the USA created a 'dollar gap', for other countries wanted to buy American goods for reconstruction without having much to sell in return. As a result, America attracted large amounts of reserves without returning dollars to the world economy. By the 1960s, the situation was reversed, for other countries recovered and the USA was spending large sums

overseas on defence, investment and purchasing goods. The result was a dollar glut which resolved the liquidity problem but created new difficulties. In 1959, Robert Triffin warned that the apparently successful conclusion of convertibility in 1958 posed dangers. The 'Triffin dilemma' was that liberalisation of the exchanges and trade was assisted by international liquidity created by American deficits and hence the supply of dollars to the world economy. If America did not allow deficits, dollar reserves in the world would be too low for the expanding world economy. On the other hand, dollars might be created too fast and lead to long-term lending on the basis of short-term inflows that would result in something like the 1931 financial crisis when the pound was devalued and the gold standard collapsed (Triffin 1960). His solution was the creation of new reserve units that would not rely on gold or the dollar, so allowing the USA to reduce its balance of payments deficit without at the same time removing liquidity from the global economy.

The Americans placed the blame, in part, on the undervaluation of the DM and, later, the yen which should be resolved by their revaluation—not something the surplus countries were keen to do given the political difficulties of hitting exporters and exposing domestic industry to competition. The Europeans placed the blame on the USA. The American deficit provided liquidity, but European countries complained that the USA was abusing the Bretton Woods system for its own ends, financing overseas military adventures and permitting 'greenback imperialism'. The Americans did not need to intervene to support the dollar or worry about the loss of foreign exchange reserves, for they had the right of 'seignorage', simply printing more dollars. In February 1965, President De Gaulle complained of this 'exorbitant privilege': 'the fact that many states accept dollars as equivalent to gold, in order to make up for the deficits in any American balance of payments, has enabled the United States to be indebted to foreign countries free of charge' (James 1996, p. 169). Similarly, the Germans complained that the Americans were exporting inflation through monetary expansion. Otmar Emminger, a member of the board of the Bundesbank, complained that 'pinning the European currencies to the Dollar through a fixed par value means pinning it to an anchor which may itself be carried off by a high tide of inflation' (Emminger 1965). Germany faced huge influxes of dollars in the expectation of revaluation, so creating inflationary pressures. The bogey of hyperinflation was in the minds of Germans, and article 4 of the 1967 law on the promotion of growth and stability put internal stability above stability of exchange rates (Emminger 1977, pp. 1–2). The dominant European view was that the Americans should resolve their domestic

difficulties of uncompetitiveness and lax monetary policies—but such action ran against electoral considerations at home. American administrations—and above all Nixon when he came to power in 1969—were not willing to allow protection of the international monetary system to take precedence over domestic economic policy or security objectives. Nixon 'relegated the survival of the postwar international monetary regime to a distant third in the priorities of the United States, lagging far behind the goals of maintaining a prosperous domestic economy and ensuring the achievement of US security objectives'. His policy was one of 'benign neglect', allowing a crisis to develop without taking serious steps and then hoping to reform after the event (Gowa 1983, pp. 13, 23; Matusow 1998, pp. 142–143).

The Bretton Woods regime was also threatened by a shift in the 'trilemma'. In 1944, fixed exchange rates that were intended to create international stability were linked to freedom for domestic economic policy by allowing controls on the movement of capital. This trade-off came under strain in the 1960s. Convertibility and growth of the international economy led to more freedom in capital movements, so putting strains on fixed exchange rates and reducing the efficacy of domestic monetary policy. Although exchange controls were retained after 1958 by most countries except Germany, it was very difficult to prevent 'leakages' such as in Hong Kong which had a free market in foreign currencies, or through disguised capital movements (Schenk 2010). The Kennedy and Johnson administrations tried to control capital movements in response to the deterioration in the American balance of payments, but it was increasingly difficult and even counterproductive. One result was that American corporations held their foreign earnings of dollars outside the USA in a 'Eurodollar' market beyond the reach of the Federal Reserve. As an official of the US Treasury remarked, 'The basic problem is that in a world where short-term capital can move freely between money-market centers, an independent monetary policy becomes difficult to achieve: an attempt by the monetary authorities to restrict the expansion of credit is frustrated as banks and non-bank firms increase their borrowing abroad' (National Archives and Record Administration (NARA), Clark to Schmidt 1971).

The Bretton Woods system of fixed rates and domestic monetary policy could only work with capital controls, and even modest capital mobility allowed speculative attacks on currencies. 'Bretton Woods proved untenable in the end because its rules could not reconcile independent national policy goals, pegged exchange rates, and even the limited degree of capital mobility implied by an open world trading system' (Obstfeld and Taylor 1997, p. 41). In the days of the gold standard, capital mobility was linked to a

fixed exchange rate with monetary policy used to maintain the rate. In the 1960s, domestic deflation was not acceptable to maintain relatively fixed rates in response to capital movements. The alternative was to link capital mobility with the pursuit of domestic monetary policies and to abandon exchange rate stability and to move to floating rates.

In the 1960s, the Bretton Woods system was kept afloat by a growing number of ad hoc interventions. Central bankers developed 'swap networks' to defend their currencies, overseen at their regular meetings at the Bank of International Settlements; a gold pool was set up to manage the price of gold; and constant, and largely inconclusive, discussions took place to find means of adding a new form of reserve or widening bands around par. Supporters of the Bretton Woods system such as Charles Coombs of the Federal Reserve Bank of New York, who was at the heart of the BIS and 'swap' networks, saw success; others claim that it was 'on life support since its inception. Between 1958 and 1968, it had only been kept alive by a series of extraordinary measures that made little long-term macroeconomic sense' (Coombs 1976, pp. 80, 188–191, 196, 198, 202–203; Gavin 2004, p. 185).

Even modest reform was difficult to achieve. One difficulty was deciding who had authority, which leads to a 'furor over fora'. The IMF might seem the obvious body to reform the international monetary system, but it was cumbersome and unimaginative, failing to rise to new challenges. Although the IMF had the widest membership, it was part of the American vision for the world after the war. Less developed countries saw it as the voice of the advanced economies, and Europeans as an 'Anglo-Saxon' institution dominated by deficit countries in the USA, Britain and the less developed countries. An alternative option was the OECD which would bring together the key countries of the Atlantic economies, with a much larger role for Europe. But it was purely consultative and lacked funding. Its influence rested on the overlap with the group of ten leading economies—Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Britain and the USA, with Switzerland joining in 1964. The Europeans preferred G10 as a body dominated by creditors who could control the feckless Anglo-Saxons and less developed countries (NARA, Cates to Volcker 1972; memo to Volcker Group 1972).

The Bretton Woods regime of fixed but variable exchange rates became, much like the gold standard before 1914, more than a monetary system. Paul Volcker, undersecretary of the Treasury in the Nixon administration who played a major role in the final days of the system, pointed out that it was 'a kind of wonderful totem, representing stability of exchange rates, freedom of payments, and less tangible, a spirit of international cooperation'.

After it collapsed, he looked back and remarked that 'It's hard now … to recapture the strength of the emotional and intellectual commitment to the international stability of the dollar and the fixed gold price …. Defending the dollar was less a burden than a badge of honor that went to the prestige and to the sense of international leadership and responsibility of the nation' (Volcker and Goyhten 1992, pp. 20, 25). The system seemed to have cured the problems of the 1930s of competitive devaluation and trade warfare. Coombs argued that the breakdown of gold standard and move to floating in 1931 created 'a new and even more dangerous form of economic barbarism. Multilateral trade had progressively given way to discriminatory, bilateral trading arrangements, reinforced by exchange controls, amid a welter of charges and countercharges of competitive depreciation through floating currency rates' (Coombs 1976, p. 4). Robert Roosa, undersecretary for monetary affairs from 1961 to 1964 and Volcker's mentor, argued that 'a system of fixed rates of currency exchanges provides the most hospitable environment for encouraging market-oriented adjustments', for it provided 'an established scale of measurement, easily translatable from one country to another, which enables merchants, investors, and bankers of any one country to do business with others on known terms'. Roosa firmly rejected floating rates as 'trying to do business with a rubber yardstick' that would 'contribute to a greater economic isolationism. A wall of currency uncertainty would be built around every country' (Friedman and Roosa 1967, pp. 30, 38, 42).

An intellectual case for floating rates had been made by Milton Friedman as long ago as 1950. He argued that floating rates were 'absolutely essential for the fulfilment of our basic economic objective: the achievement and maintenance of a free and prosperous world community engaging in unrestricted multilateral trade'. Multilateral trade was the main aim of policy, but there had been little success in removing trade barriers because of the commitment to 'an essentially minor goal' of rigid exchange rates. He accepted that it was no longer possible to adjust the balance of payments by altering internal prices and incomes. Friedman favoured flexible exchange rates where any move in the balance of payments immediately affected the exchange rate, and at once prompted corrective action. By contrast, fixed exchange rates meant that steps to correct the balance of payments could be delayed, and when something was eventually done, it was by administrative action such as controls on capital flows or prices rather than market forces. Friedman argued that hostility to floating rates rested on a combination of opposites. Traditionalists wanted to return to the certainties of the gold standard with its ability to constrain domestic policies and therefore had

no sympathy with floating rates. Reformers distrusted the price mechanism in all forms. The result, Friedman remarked, was a 'curious coalition of the most unreconstructed believers in the price system, in all its other roles, and its most extreme opponents', with the result that floating exchanges were not even considered in the debates leading to the Bretton Woods conference. Friedman believed that flexible exchange rates would in fact be stable, for 'the ultimate objective is a world in which exchange rates, while *free* to vary, are in fact highly stable. Instability of exchange rates is a symptom of instability in the underlying economic structure'. In his opinion, fixed exchanges 'froze' the economy by requiring various controls in order to protect the rate; if everything were flexible, the economy could respond to changing conditions and exchange rates would consequently remain stable as a result of the free play of market forces (Friedman 1953). His case was still stronger by the 1960s, for he argued that the fixed rate regime only survived as a result of controls on capital movements, import restrictions, exchange controls, with pressure to deflate in the USA and inflate in Germany. Why force all prices in a country to adjust rather than altering one, flexible price—the exchange rate. Economic policy could then be directed to 'internal stability without being hamstrung by the balance of payments'. In his view, Roosa exaggerated the uncertainties of floating rates. For one thing, the context was different from the 1930s when countries pursued competitive devaluation in order to increase employment; now, full employment removed that temptation. And the risk of currency fluctuations could be removed by hedging (Friedman and Roosa 1967, pp. 11–15, 17, 20, 73, 90–91, 118).

Friedman's views were heretical to many officials such as Roosa and Volcker who defended the status quo of Bretton Woods and wanted evolutionary change. The alternative of floating simply seemed too dangerous and a return to the perils of the interwar period—though Friedman pointed out, with justice, that the problem arose from the fixed rate of the gold standard and that floating allowed recovery. Roosa felt that hedging risks was not possible, given the lack of any benchmark and the constant interference of governments in the market to gain an advantage (Friedman and Roosa 1967, pp. 40, 46–47, 49, 51–52; Bernanke and James 1991). After Nixon closed the gold window on 15 August 1971, an attempt was made to put the Bretton Woods regime back together again by resetting parities and increasing the bands. But it was soon clear that the Americans were not willing to defend the new rates, and the world moved to floating in the early 1970s—not as a result of the intellectual force of Friedman's arguments so much as a pragmatic response to circumstances. The Germans had temporarily floated in 1969, and Emminger pointed out that 'destabilizing

international money movements could be fended off only by recourse to the weapon of flexible exchange rates' (Emminger 1977). In 1973, floating was adopted more generally—and now the obsession with fixed rates seems puzzling. Friedman was right that currency markets emerged to hedge risks—but Roosa also had a point that monetary authorities would intervene to secure an advantage. More significantly, the emergence of floating allowed the expansion of capital flows and the emergence of hyper-globalisation.

3 The Capital Movements Trade-Off: Why Were Capital Movements Controlled or Free?

Capital mobility is possible when one of two conditions apply. The first condition is when domestic monetary policy is subordinated to the exchange rate, as on the gold standard. The second is when exchange rate stability is subordinated to domestic objectives and currencies are allowed to float. In the late nineteenth and early twentieth centuries, the first condition applied, and foreign assets as a proportion of world GDP rose, on a rough estimate, from 7% in 1870 to 19% in 1900. Foreign assets as a proportion of world GDP then fell back to 8% in 1930 and 5% in 1945. The level only rose to 6% in 1960, before surging to 25% in 1980 and 62% in 1995 under the regime of floating (Obstfeld and Taylor 2004, p. 55).

There was not only a change in the level of capital movements, but also in its character and economic impact. Britain was the major source of capital exports before the First World War, with overseas assets amounting to 6.8% of net national wealth in 1850 and 35.2% in 1913. Overseas investment experienced a cycle, falling from 62% of gross domestic fixed capital formation in the late 1880s to 37% in the 1890s, before rising to an astonishing level of 76% between 1905 and 1914—and it was countercyclical to the domestic economy, so acting as a stabilising force in the world economy (Feinstein and Pollard 1988, p. 169; Pollard 1989, p. 61; Stone 1999, p. 7). To some contemporaries, capital exports were beneficial. Robert Giffen defended capital exports in 1905, arguing that 'a rich class at home living on its foreign income is, on the whole, a desirable class for a country to possess'. He argued that large fortunes and incomes led to savings and hence to investment and employment—and investment overseas was just as beneficial as investment at home in leading to the import of cheap goods and stimulating

export markets (Giffen 1905, p. 493). On the other hand, J.A. Hobson feared that overseas investment arose from a maldistribution of income and wealth which meant that domestic markets and investment opportunities were limited. The solution was not to limit capital exports but rather to redistribute wealth at home so that capital exports did not arise from a pathological social structure. Capital exports could still lead to a Cobdenite vision of peace and prosperity (Hobson 1902, pp. 134, 147–148).

The assessment of the benefits of British capital exports changed after the First World War. In the post-war boom, firms in a number of leading export sectors—above all cotton, shipping and steel—incurred high debts for what turned out to be inappropriate ventures or flotations at excessive prices. As a result, British industrialists were burdened with high costs of servicing loans out of narrower profit margins, and the high level of debt created dangers for British banks which had lent unwisely to industry. The Bank of England now had to be concerned about the domestic economy, for a collapse of British businesses would threaten the stability of the banking sector. These new circumstances contributed to a reassessment of the trade-off between domestic and international concerns, for the Bank's need to support domestic policy meant that it could not pursue international considerations so clearly as before the war—and one outcome was restriction of capital flows in order to limit pressure on domestic monetary policy.

Capital controls were imposed during the First World War and remained in some form for much of the interwar period. The motivation was in part domestic—the need to invest in 'homes fit for heroes', and to convert short-term into long-term government debt—and in part international, to protect the pound without imposing still higher interest rates with serious domestic consequences. Supporters of capital exports followed Giffen's line in arguing that they encouraged exports, sustained the empire and led to business for the City. But not everyone at the Treasury was convinced, arguing that the situation was different from before the war when there was a large balance of payments surplus available for overseas investment—though equally it did not want to 'waste' investment on public works at home at the expense of more productive investment abroad. Policy towards capital mobility had changed from passive acceptance prior to 1914 to a careful estimation of the benefits for the economy as a whole, and an assessment of its political ramifications (Atkin 1970; Daunton 2007, pp 14–21; Clarke 1990, pp. 180–183). The change was clear in the United Nations' survey of capital movements which estimated that net capital exports from the UK between 1911 and 1913 were $1042m; during the First World War, something like $4000m of foreign investments was sold. After the war, capital exports at first returned

to the earlier pattern, reaching $881m in 1921. But the recovery was temporary, with exports in 1922–1928 amounting to only $407m. In the 1930s, the UK became a net importer of capital, amounting to $313m in 1931 and $269m in 1938, or an annual average of −$74m in 1931–1935 and −$212m in 1936–1938 (UN 1949, pp. 4, 10, 15).

After the First World War, the major source of capital exports was the USA, but the nature of this investment was different. British overseas investment was largely portfolio rather than direct investment by British firms, and it was countercyclical. By contrast, a greater proportion of American investment was direct investment by American firms in overseas ventures, and it followed the domestic cycle. Furthermore, Britain kept its markets open before 1914 so that additional output could be sold and payments maintained; America erected tariff barriers and so created problems in disposing of output. There was also concern about the political impact of overseas investment. The American government intervened in a number of Latin American and Caribbean countries to protect investments and to impose fiscal discipline which created the potential for over-lending and 'moral hazard', as well as provoking complaints of neocolonialism (Kindleberger 1973, pp. 291–307).

The problems with American investment after the First World War led to concern in the 1930s that the irresponsible behaviour of financiers adversely affected American interests, and entailed manipulation of local politics. Congressional investigations found that large commissions were paid to American financiers, with onerous terms, a wasteful use of loans and defaults. Policy shifted to remove 'moral hazard' and to end intervention. The new approach to Latin America and the Caribbean was set out by Roosevelt in his augural address when he pledged himself to 'the policy of the good neighbour' (Roosevelt 1933a; Helleiner 2014, Chapter 1). During and immediately after the Second World War, discussions took place whether to control 'undesirable' American foreign investment. Some voices in the administration warned that over-expansion of foreign investment might have the same effect as in the 1920s, leading to hostility towards America as a result of exploitation of natural resources, special privileges given to American corporations and manipulation of local support. For these reasons, in 1946 a working group of the National Advisory Council and the Executive Committee on Economic Foreign Policy recommended registration and administrative controls over foreign loans. The approach was far from universally accepted, and a report from the Committee on Foreign Investment Policy concluded that 'Properly conceived foreign investment is of substantial benefit to the United States and the world generally. The benefit has to do

especially with the expansion of production and trade, with facilitating the maintenance of prosperity and employment, with raising standards of living, and with the promotion of general security'. The report argued that private loans were better than government loans which should only be used when private capital was not available or when schemes were very large and public in nature (NARA, Control over American Private Foreign Investment 1946; US Foreign Investment Policy 1946).

The issues resurfaced in the discussions at the conferences on trade and employment at Havana in 1947–1948 to establish an International Trade Organization when the views of underdeveloped countries collided with American assumptions. The American delegation was anxious to stimulate overseas investment as a way of encouraging recovery of the international economy. Businessmen wished to insert a chapter into the Charter of the ITO to stimulate American foreign investment in 'economically desirable purposes' as a way of assisting recovery and dealing with the trade surplus and dollar shortage by injecting funds into the world economy. They argued that the chapter needed to provide security for investment which was currently too risky because of the policies of many countries, especially in Latin America. As they pointed out, it was one thing to deal with the ordinary risks of business, but quite another to deal with 'the hazards of debt repudiation, property confiscation, foreign exchange blockages, and discriminatory practices'. In the absence of security, American overseas investment would come to a halt and the costs of stimulating recovery would instead fall on the American government and taxpayer. There was a careful balance to be struck. If the chapter were strengthened to offer more security for American investment, it would be criticised as being no more than a disguised form of imperialism. If the chapter were not strengthened sufficiently, American businessmen would denounce the ITO for offering inadequate protection and making the world safe for socialistic planning (NARA, Investment Clause in Geneva Draft 1947; Appraisal, National Association of Manufacturers 1949).

One way of squaring the circle between the destabilising and stimulating role of overseas investment was public investment through an international institution—the International Bank for Reconstruction and Development. What should be the basis of investment by the IBRD? Should it focus on wider programmes for economic development or narrower project loans? Paul Rosenstein-Rodan argued for 'balanced growth', building on his work of 1943 on eastern and south-eastern Europe which he extended to five 'vast international depressed areas'. The basic problem was the existence of 'agrarian excess population' and disguised unemployment. Since it

was unlikely that migration to richer areas would be feasible, machinery and capital would need to be taken to labour through industrialisation. This task could be undertaken in one of two ways. The first solution was self-sufficiency without international investment as in Russia, an unsatisfactory approach that would lead to a loss of output as a result of inappropriate division of labour. He preferred a second approach: large-scale international investment and integration into the world economy, with specialisation in labour-intensive light industries. In the Far East, with its huge population, he felt that industrialisation would play a smaller role and instead agriculture should be diversified. New policies were needed in order to achieve his ambition. The nineteenth-century pattern could not be adopted, for international investment was no longer self-liquidating by exchanging agricultural and manufactured goods, and investment in individual concerns was not effective for the industrialisation of a whole area. Furthermore, high fixed capital and overheads for industrialisation meant high risks, so that state supervision and guarantees were needed. In Rosenstein-Rodan's opinion, a different institutional framework was required to plan industry as a complementary system. Private international investment looked for individual returns to the investor based on past experience and did not take account of social returns and externalities. If all new industries could be combined in a single unit, what would otherwise be external economies would become an internal profit. It was also necessary to plan the liquidation of the investment by ensuring that some industries exported goods to creditor countries (Rosenstein-Rodan 1943, 1944).

Nurkse took a similar line. His report for the League of Nations on international currency movements in the interwar period argued that they were destabilising by spreading panic as 'hot' money fled from one country as a result of a loss of confidence (Nurkse 1944). Nurkse was reassured that capital flows after the Second World War escaped from the speculation of the 1920s and 1930s, but he also claimed that they had not returned to the beneficial pattern prior to 1914. Capital exports now arose mainly from the reserves of businesses (largely American) and led to the supply of a few basic commodities for the industrial world at low prices. After the Second World War, direct ownership of capital linked American technological knowledge with the employment of low-waged local labour in an export-oriented sector with limited connection with the rest of the domestic economy. The result was a colonial type of investment that created lop-sided growth and 'specialization based on a static scheme of comparative advantage', with dependence on foreign demand for one or two commodities, low levels of internal demand and instability. Such a pattern of growth would not be as beneficial

as in the nineteenth century, when primary producers such as Argentina had high per capita incomes. Unlike Britain before 1914, the USA did not need to import so many raw materials and foodstuffs, so that growth was less likely to come from primary products, and the trade was increasingly between advanced countries. In his view, what was needed was 'a balanced pattern of investment in a number of different industries, so that people working more productively, with more capital and improved techniques, become each other's customers'. Nurkse felt that direct investment by business corporations alone could not provide international finance for development. What was needed was a revival of social overhead capital with a more beneficial impact on the domestic economy, on the lines of British investment in government loans or investments in utilities such as railways and ports which aided development, and took the form of fixed interest bonds. Such investment was not, he argued, of a colonial nature. It produced raw materials and food for Britain, but most of the funds went into overhead capital and above all railways, rather than directly into primary production. It therefore benefited the economy as a whole (Nurkse 1954 and 1961).

The IBRD moved increasingly towards investment in specific, financially viable project loans or unbalanced growth. Albert Hirschman argued for unbalanced growth, believing that the problem was not a scarcity of resources but rather providing motivations or inducements to mobilise existing, under-used resources. Domestic capital, skills and institutions were lacking for a short 'big push', and he argued for smaller steps to stimulate investment and project loans for directly productive activities. In his view, a wide programme would benefit some groups and harm others, so generating internal political opposition; by contrast, a single, defined project would be easier to implement. Instead of a 'propensity to plan', he argued for a 'propensity to experiment and to improvise'. Balanced growth would eventually appear as a result of the expansion of the market, through a succession of disequilibria or imbalances. This meant acting through entrepreneurs who precipitated problems by putting pressures on other areas of the economy and so created new opportunities, rather than through planners who tried—and often failed—to anticipate problems. His approach was 'possibilist', arguing that complete knowledge was not possible, that it was only possible to grope for change in conditions of uncertainty. Smaller-scale processes were to be preferred to grand schemes (Adelman 2013, pp. 298–309, 321–323, 333, 338–349, 437).

The decision of what approach to adopt arose when the IBRD sent its first general mission to Colombia in 1949, which posed a major question of what it should finance, on what grounds? The head of the mission,

Lauchlin Currie, argued for a policy of balanced growth. Labour should be moved from the land into a series of industries which would assist in creating a market, providing incentives to invest and delivering a 'big push' to power the economy into self-sustaining growth. Balanced growth required programme loans, an integrated development plan and investment in social overhead capital. But the IBRD was sceptical and preferred productive project loans. Their attraction to conservative New York bankers who dominated the IBRD was that they were self-financing and liquidating, and finite and bounded in a particular sector such as the construction of a hydro-electric scheme or railway. Furthermore, they avoided the charge of undermining national sovereignty and interfering in domestic politics that could be said of wider programmatic loans (Alacevich 2009; Kapur et al. 1997).

These debates over development were linked to American foreign policy and modernisation that was associated with Walt Rostow, a professor of economic history and a member of the administrations of Presidents Kennedy and Johnson where he was a hawk on Vietnam. His stance on the war was closely linked with his approach to economics and modernisation theory. Modernisation theory combined confidence that nations would undergo a transition from tradition to modernity (much as Britain and the USA) with a realisation that it posed grave dangers. Traditional society was characterised as inert and inflexible, introverted and superstitious, wary of change, dominated by agrarian elites, lacking a powerful middle class and relying on a simple economy, limited technology, subservience to nature and a general sense of fatalism. A modern society was characterised as more like America: flexible and adaptable, welcoming change, secular and outward looking, with a complex economy based on division of labour, and a willingness to subjugate and exploit the physical world.

It was a remarkably simplistic view of history that was remarkably powerful, helping to shape American economic and foreign policy in the 1960s as an alternative to Communist solutions to development. According to modernisation theorists, the transition from tradition was started by colonialism, with unfortunate results. The European empires destroyed the cohesion of traditional societies without making them fully modern, and even worse, led to suspicion of modernity as a colonial imposition. Benign American modernisers should replace European exploitative colonialists, creating a pattern to emulate rather than an imposition to reject. What was needed was a capitalist alternative to Marx and the Soviet path to modernity. The danger was that, in the initial stages, the dislocation of traditional society created 'dangers of instability inherent in the awakening of formerly static peoples', so allowing Communists to exploit the disruption of traditional society

for their own ends. Once societies passed through this difficult phase, the opportunities for Communism would decline, but in the short term it was vital to take military action as well as encourage economic development. Here was a justification for American aid and for Rostow's suggestion that the 1960s be declared the 'development decade' (Gilman 2003, pp. 49, 179; Latham 2000).

Yet at the same time as Kennedy announced the development decade, the American balance of payments started to deteriorate. Although the US Treasury was anxious to preserve a free capital market, J.K. Galbraith, an economic adviser to Kennedy, strongly supported capital controls on grounds of both domestic politics and international strategy. He was alarmed by the accumulation of dollars in foreign hands, with the potential of converting them into gold. 'We are financially weak and our allies have become strong and more than a trifle arrogant as a result. If the weakness continues we will be able to keep our military and economic aid commitments only by borrowing. In consequence we will have the economic and political weakness of a debtor nation'. Restricting long-term capital flows was the least damaging response. Savings would flow into domestic investment rather than overseas, and interest rates could be kept low. Although he was not enthusiastic, George Ball, undersecretary of state for economic affairs, agreed that capital controls would be less of a threat to American leadership than deflation of the domestic economy or large troop deployments. The result was an Interest Equalization Tax to make borrowing in America more expensive for foreigners, without increasing interest rates for domestic investment. The Johnson administration moved to greater controls on capital exports in 1967 through a tax on direct American investment, on the grounds that it would appeal to European concerns about American takeovers, without violating international agreements (FRUS 1961–1963 IX, docs 24 and 32; Kennedy 1963).

In reality, holding back capital flows was not easy. Capital controls could be circumvented by disguised capital movements, or through the Eurodollar market. The emergence of even limited capital mobility in the early 1970s was sufficient to allow speculative attacks on major currencies, encouraging a shift to floating rates. And once floating rates were adopted, industrialised countries could deregulate capital flows and pursue domestic goals without the need to defend fixed exchange rates (Obstfeld and Taylor 1997, 2004). The shift to much higher levels of capital mobility created gainers and losers. In general, financial integration implies an increase in the social and political power of mobile capital than less mobile labour. However, some capital is more mobile than others, for investment in infrastructure, farming or manufacturing is more rooted in a particular place than financial capital or the

assets of multinational corporations. Increased mobility is good for investors with mobile assets in the developed world and for internationally diversified multinational corporations; it is not good for nationally based capital specific to a particular place and industry. Capital mobility also affects attitudes towards the exchange rate. International traders and investors, and producers of export-oriented tradable goods are more likely to prefer a fixed rate or low flexibility despite a loss of monetary policy autonomy. Producers of non-tradable goods and services, and producers of import-competing tradable goods for the domestic market, are more likely to favour flexibility in exchange rates and autonomy. These preferences in turn affect attitudes towards macroeconomic policies. Capital mobility combined with an expansionary monetary policy leads to depreciation of the currency and benefits producers of tradable goods. On the other hand, an expansionary fiscal policy leads to appreciation of the currency which benefits producers of non-tradable goods and services. As Jeffrey Frieden remarked in 1991, 'the distributional consequences of international capital mobility are striking. In the long run, owners of capital have probably gained relative to other groups. In the shorter run, owners and workers in specific sectors in the developed world face serious costs in adjusting to increased capital mobility' (Frieden 1991). Twenty-five years later, his comments on the distributional consequences of high capital mobility in the era of hyper-globalisation were prophetic.

4 The Free Trade Versus Protection Trade-Off: Why Was Free Trade or Protection Adopted?

Both Roosa and Friedman argued that currency regimes were linked to trade policies—but they took different approaches. In Roosa's opinion, fixed rates gave security for traders and reduced risk; a shift to floating rates would create so much uncertainty that they might turn away from multilateralism. Friedman argued that attempting to maintain fixed rates led to import duties in order to deal with a balance of payments deficit (as in the USA) or to export duties to deal with a surplus (as in Germany). In his view, floating rates were compatible with free trade (Friedman and Roosa 1967).

In reality, both fixed and floating rates could be combined with either free trade or protectionism. Britain was committed to the gold standard and free trade, whereas the USA combined gold with high tariffs. Equally, floating

rates were associated with protection in the 1930s and with multilateralism in the late twentieth century. Understanding the choice requires an analysis of the changing dynamics of domestic politics that allowed one policy or the other to succeed, and an appreciation of international rules that constrained 'beggar my neighbour' policies of protectionism. These two levels of analysis were closely connected, for the resurgence of protectionism in domestic politics could be contained by international rules negotiated in different circumstances.

One of the most significant changes was the move of Britain from free trade before 1914 to imperial preference after 1932, when the world seemed to descend into trade blocs and bilateralism (Trentmann 2008). Another significant change—and the one that I will consider—came into play with the shift of the USA from the notorious Smoot-Hawley tariff of 1930 to its championing of multilaterism and free trade, underwritten by international rules and agreements. Understanding this shift entails analysing the changing balance of power in domestic politics, and the relationship between Congress and the executive.

The Smoot-Hawley tariff was the latest battle in a long war between Democrats and Republicans over trade policy. One of the most vocal supporters of lower tariffs was Cordell Hull, a Democrat member of the House of Representatives from rural Tennessee who went on to serve as Roosevelt's Secretary of State from 1933 to 1944 where he played a major role in trade policy. In 1913, he supported lower tariffs as a way of raising domestic prosperity and of preventing monopolies and trusts. In 1916, he came to see that free trade was vital for peace. The experience of the First World War convinced him that 'wars were often largely caused by economic rivalry conducted unfairly. I therefore came to believe that if we could eliminate this bitter economic rivalry, if we could increase commercial exchanges among nations over lowered trade and tariff barriers and remove unnatural obstructions to trade, we would go a long way toward eliminating war itself' (Hull 1948, pp. 81, 84). He held to this view in the 1930s, and Harold Ickes, Secretary of the Interior, felt that the attempt to make peace through trade was 'like hunting an elephant with a fly-swatter' (Ickes 1954, pp. 218–219). Hull's view would have been familiar to Richard Cobden, the British free trader, a century earlier, to whom the repeal of the protective Corn Laws in 1846 was a means to both peace and prosperity. In Britain, opinions evolved beyond Cobden by the First World War, where a different lesson was drawn that success rested on international coordination and planning, and free trade needed to be combined (as Hobson argued) with redistribution to create a prosperous home market. Free trade and multilateralism meant

different things on both sides of the Atlantic, leading to a failure of understanding in the debates after the Second World War (Trentmann 2008).

Hull was a Southerner, and the South was traditionally committed to an open international market as an exporter of raw cotton and other primary products, and an importer of manufactures from the northern USA and Europe. Import duties were therefore seen as a way of boosting the profits of northern industrialists, financing government at the expense of the poor and harming the ability of foreign countries to buy Southern commodities in an open world economy. A commitment to free trade was therefore more likely when Southern Democrats could shape policy in Congress, insisting on policies that met their approval—such as freer trade and more stringent regulation of bankers and financiers. This Southern influence meant that an open world trade system and liberal capitalism were linked with a 'hierarchical racial order' to which Hull was committed (Katznelson 2013, pp. 9, 15–16, 18, 21, 23–25, 95, 127–129, 143, 145–146, 150–155, 161–164, 172–177, 182, 191–194, 233, 261, 265, 274, 280–281, 287–291, 370–372).

In 1928, the Republican presidential candidate, Herbert Hoover, campaigned for tariffs to protect American farmers from the worldwide collapse of commodity prices that was causing them serious economic hardship. In reality, tariffs on imports did little to help American farmers who were major exporters, and would not solve the main problem of low world prices caused by over-production and lack of demand. Certainly, Hoover did not intend higher tariffs to apply to industrial goods, but his initially modest proposal was widened in the Republican platform for 1928. When Hoover won the presidential election, Congress turned to the revision of duties as the boom of the 1920s gave way to the Wall Street crash of 1929 and the onset of depression. The Smoot-Hawley tariff of 1930 started its unedifying passage through Congress in an atmosphere of crisis. Although the vote for and against the Bill as a whole was on party lines, support for individual duties was influenced by local economic interests, with members of Congress trading votes to support each other's pet duty. The Smoot-Hawley Bill only passed by a narrow majority, and Hoover himself felt that the duties were excessive (Irwin 2011).

A return to more open trade would only be possible if the power of Congress to set general tariffs was reduced and authority was given to the president, on the same lines as in other countries where the executive had more power. Why would Congress voluntarily surrender its powers to the executive? The experience of negotiating the Smoot-Hawley duties had been a bruising one for many Congressmen, and it might be assumed that they learned the lesson that a pursuit of narrow localism through log-rolling

harmed the national interest. In reality, few Congressmen learned a lesson: only nine out of 95 members of Congress who voted for the Smoot-Hawley tariff in 1930 and were still legislators in 1934 supported the delegation of power to the president. Other reasons must have been of greater importance. One was the general sense of crisis and the need for emergency action. More significantly, the Democratic Party had control of both Houses, with a large number of Congressmen from the South who were firmly committed to free trade. It was a rare opportunity that Democrats could not let slip, and they were determined to 'lock-in' lower tariffs by removing authority from Congress. Since the end of the Civil War, the Democrats only had unified control of both Houses for four of 33 Congresses, and the tariff reductions they achieved in 1894 and 1913 were soon reversed. Passing an Act to reduce tariffs was not enough. What was needed was a method of institutionalising low tariffs (Haggard 1988).

The Reciprocal Trade Agreement Act (RTAA) locked-in low tariffs in three ways. First, authority was delegated from Congress to the president. At least until 2017, Republican Presidents have not been as protectionist as Congress, for they were less concerned about specific local interests and more with the balance of national interests. Second, the Act provided that trade agreements no longer needed a 'super majority' of two-thirds of Senate. In future, all that was needed was a simple majority to renew the RTAA every three years. Senators could no longer make log-rolling deals as in 1930. The change in the success rate of trade agreements was striking. Between 1844 and 1909, when authority was not delegated to the president, a total of 21 trade agreements were proposed to Senate, and only three were accepted. By contrast, a total of 27 trade agreements were successfully negotiated between 1934 and 1946, and another 24 in 1947–1948. Third, the RTAA established the principle of reciprocity. In the past, tariffs were set unilaterally by the USA without negotiating with other countries. This procedure gave more power to protectionists, for support for an increase in the import duty on a specific commodity was heavily concentrated in particular firms and locations which gave them more political voice. By contrast, supporters of lower tariffs had less voice, for the impact of higher costs fell on consumers who were less active, more diffuse and more difficult to mobilise. Furthermore, reciprocity changed the balance between protectionists and free traders within American domestic politics. An increase in American tariffs would now immediately lead to higher duties on American goods, and the only way for exporters to secure better overseas markets was to support lower American import duties. Negotiations followed the principle of the most favoured nation—that is, the signatories to a trade

agreement are committed to treat each other as well as they treat a third party. Hence, if countries A and B negotiate an agreement, any concession made in a later agreement between A and C would be extended to B—and any agreement between B and D would be extended to A and C. By this means, no country would be treated worse than the country that is treated best in any bilateral agreement. The concern that such unconditional most favoured nation agreements gave 'something for nothing' was removed by the 'principal supplier' rule. America would offer concessions only to the country that supplied the largest proportion of imports of a particular commodity. Thus, tariffs were reduced on coarse and medium wool in the trade agreements with Argentina and Uruguay in 1935, but not on fine wool that came from Australia. A concession on all wool would have given Australia an unreciprocated benefit. This approach meant that industries facing competition from several countries were still sheltered, striking a balance between the most favoured nation principle and the expansion of trade on the one side, with protection of domestic interests on the other. The RTAA marked a major shift in the dynamics of trade policy and in its essentials continued after the Second World War.

Of course, Republicans could always reverse the RTAA at some future date when it came up for renewal, by increasing the influence of Congress, inserting various loopholes or completely rejecting renewal. The danger grew as Republican numbers in Congress increased. Survival of institutional 'lock-in' depended on a number of other developments. By giving more power to the executive—and especially the State Department—the RTAA created more expertise and administrative capacity that could counter congressional lobbying. Reciprocity gave more incentives to export sectors to mobilise in favour of trade liberalisation, and the recovery of world trade meant that they became a larger sector in the American economy—though never so large as in Britain. Republicans started to change their position, moving from opposition to the RTAA to greater support in the renewals of 1943 and 1946. When the Act was passed in 1934, 53 Democrat Senators voted for the measure and five against; by contrast, six Republicans voted for and 30 against. When the vote on renewal was taken in 1945, Democrat Senators split 45 to 7 but now 15 Republicans supported renewal as against 21 opponents. Although the Republicans won control of Congress in 1946, the RTAA survived. In 1948, 98% of Republicans in the House and Senate voted to renew the measure, though only for one year and on condition that 'peril points' were introduced—that is, the point at which a reduction in duties would cause serious harm to an American industry. In 1949, with a return of a Democratic majority, the RTAA was renewed for three years

without peril points and with the support of 57% of Republicans in the House and 45% in the Senate (Bailey et al. 1997; Irwin and Kroszner 1999; Haggard 1988).

The RTAA was periodically renewed to give the president authority to negotiate trade 'rounds' under the General Agreement on Tariffs and Trade (GATT)—which bring us to the second institutional reason for the growth and survival of multilateralism: a bargaining process that allowed agreements and rules that limited a return to protectionism. The GATT was an interim agreement between 23 countries in October 1947, pending the creation of an International Trade Organization that did not come into existence—a blessing in disguise, for it was far too unwieldy and all-encompassing. The initiative emerged from the 'Proposals for consideration by an international conference of trade and employment' published by the USA in December 1945 which immediately exposed the differences of opinion. Hull's concern was with freer trade, and the addition of employment arose from pressure from other countries—and above all Australia—for full employment of the resources of the world in order to resolve the difficulties of low prices for primary products (Macintyre 2015). The proposals remarked that 'achieving fairness and equity in economic relations between states' rested on 'the attainment of approximately full employment by the major industrial and trading nations' which was 'essential to the expansion of international trade on which the full prosperity of these and other nations depends' (Proposals 1945). Such sentiments appealed to the more radical ideas of former vice-president Henry Wallace in the USA and to the post-war Labour government in Britain which was precisely the problem: the approach was redolent of planning and socialism that was anathema to many Americans. Would full employment not follow from the creation of freer trade rather than the other way round? Would a free market economy be subverted by state intervention in order to create full employment? (Daunton 2010, pp. 60–65).

These issues were compounded by the growing voice of the less developed countries, as Australia's representation of primary producers was taken over by India and above all Latin America which inserted demands for economic development and changing the balance between industrial and primary producing countries. Merely creating free trade would not solve their fundamental problems without a structural shift in the terms of trade between the two groups of countries. The Americans decided that voting should differ from the weighted system used by the IMF, where they and other advanced industrial countries could dominate. Instead, it was decided to adopt one country one vote in order to secure support from as many countries as possible,

in the mistaken belief that they would be grateful. The outcome at the conference in Havana in 1947 and 1948 was that a draft charter was agreed which had no chance of being accepted in Washington. The American negotiators were playing a two-level game, making concessions in Havana that secured support from the less developed countries on issues, but at the expense of support on Capitol Hill. The charter was too all-encompassing and riven by fundamental differences of approach, and in 1950, President Truman simply announced he would not seek ratification (Daunton 2010, pp. 72–76).

The interim GATT survived—just that, an agreement rather than an organisation. It was able to negotiate a series of trade deals or 'rounds' that led to reductions in trade barriers. The limited scope of the GATT was more realistic than the Charter of the ITO with its conflicting and unrealistic ambitions. The failure of the ITO and survival of GATT could carry forward trade liberalisation because it had a clear focus, and rested on the commitment of members to achieve a deal through negotiating a consensus (Anderson and Hoekman 2002, p. 221; Narlikar 2005). GATT was much more palatable to Congress and to business. It did not have an executive board or secretariat and was only informally connected with the UN. It was merely an agreement between the contracting parties who would meet to discuss trade on an ad hoc basis. Dean Acheson realised that GATT was much more realistic than the ITO and would 'help to float the program (renewal of the RTAA) over the shoals of the opposition of individual protectionist groups' (Zeiler 1999, p. 161).

Of course, the less developed countries criticised GATT as a club of rich countries that, in common with the IMF, failed to address their concern—and they pressed their own demands through the Economic and Social Council of the United Nations, the Bandung Conference of Asian and African countries in 1955, and eventually the United Nations Conference on Trade and Development. In 1961, a resolution from less developed countries proposed a conference on world trade, and the Soviets saw an opportunity. In May 1962, Khrushchev denounced the Common Market as a form of neo-colonialism and called for an international trade conference and an increase in the average price of raw materials. The Americans realised that opposing a conference would confirm Soviet criticisms of America and the EEC, and it was agreed to call a United Nations Conference on Trade and Development which convened at Geneva in 1964 (Cordovez 1967; Toye and Toye 2004, Chapter 8; Rubinstein 1964, pp. 170–171). The secretary general was Raúl Prebisch, an Argentinian who had joined the United Nations Commission on Latin America. Prebisch moved away from the Latin American policy of

import substituting industrialisation that emerged in the 1930s, and realised that excessive industrialisation could actually harm welfare. The small size of national markets 'often made the cost of industries excessive and necessitated recourse to very high protective tariffs' which stifled incentives and efficiency. He argued that import substitution should be combined with exports, but 'outward-looking' industrialisation would only be possible if developed countries opened their markets on preferential terms (Toye and Toye 2004, pp. 138–139, 144–147, 158–160). Prebisch insisted that the terms of trade were detrimental to primary producers, with a need to change the structure of trade relations and not merely open markets. UNCTAD has been described as 'a twenty-year revolt against free-trade orthodoxy by economists inside the United Nations' (Toye and Toye 2004, p. 5). UNCTAD challenged the existing multilateral institutions and their ideology of free trade and comparative advantage. What was needed was fair and remunerative prices for their commodities, preferential trade deals without reciprocity and financial assistance (Joint declaration).

GATT was able to reduce trade barriers, above all on industrial commodities, through a series of 'rounds', using the principles of 1934 in a multilateral setting. The final Uruguay round started in 1986 and was completed in 1994. The interim arrangements of GATT gave way to a new international agency after the Uruguay round of trade talks. The World Trade Organization reunited the concerns for trade and development that dominated the talks at Havana in the so-called Doha Development Agenda (DDA) of 2001—an initiative that led to some of the same tensions and deadlocks as at Havana. The experience of Havana and the DDA has the same lesson: issues can be dealt with more effectively if compartmentalised rather than combined (Daunton 2010, p. 78). The Doha round has not been completed, and attention turned to regional trade deals such as Transatlantic Trade and Investment Partnership and Trans-Pacific Partnership which also faltered with a return of more nationalistic views.

The success of the WTO was in creating a set of rules and dispute settlement mechanisms which limited protectionism after the Great Recession of 2008. Barry Eichengreen and Kevin O'Rourke found that the fall in world industrial production by April 2009 was at least as severe in the nine months after the peak of April 2008 as after the peak of June 1929. Even more seriously, given its role in the Great Depression, world trade was falling faster. The world economy continued to fall for three years after 1929, and Eichengreen and O'Rourke warned policy makers that their action or inaction would determine whether the fall would continue so long after 2008. In February 2010, they reported partial success, for the world economy had

stopped its slide into the abyss and both world industrial production and trade started to recover after a year (Eichengreen and O'Rourke 2010). The WTO found that protectionist measures were largely resisted by the G20, and new restrictions imposed between October 2008 and October 2010 amounted to only 1.8% of G20 imports and 1.4% of total world imports so that trade remained more open than it had ever been, despite concerns about currency manipulation and the emergence of preferential trade agreements. Although restrictions did subsequently increase, there was nothing on the scale of the 1930s, and the WTO reported in June 2014 that 'the overall trade policy response to the 2008 crisis has been significantly more muted than expected based on previous crises. The multilateral trading system has acted as an effective backstop against protection' (WTO Report 2010). Whether it continues to do so is an open question, given the Trump administration's weakening of G20's commitment to open markets in March 2017.

Daniel Drezner argues that the institutions of global governance, for all their faults, provided a set of principles and procedures around which countries could converge, constraining domestic political pressures for protection, unlike in the 1930s when such institutions did not exist. He goes on to argue that economic changes created by globalisation strengthened economic interests committed to an open economy. Above all, effective international action was possible because economic power remained highly concentrated and, despite their differences, the leading economies of the world—the USA, EU and China—were committed to an open international economy. The Great Depression was different, for a weakened Britain could no longer provide leadership; the USA lacked the will; Nazi Germany acted as a 'spoiler'; and the Soviet Union was outside the world economy. Drezner claimed that in the Great Recession no one major power acted as a 'spoiler'. Further, the economic ideas underpinning an open global economy were not discredited as in the 1930s by alternative ideologies of Communism, fascism or economic nationalism. He was confident that the ideology of an open world economy survived (Drezner 2014, pp. 23, 25–27, 77–79, 106–108, 152–155, 175). Whether his optimism is right now remains to be seen, for Drezner had not allowed for the possibility that the 'spoiler' could be the USA itself, the main architect of the post-war multilateral system, and the economic changes created by globalisation could also strengthen opposition to an open economy.

The backlash against globalisation was not anticipated by many economists and political scientists, though Rodrik's warnings against the perils of hyper-globalisation and Frieden's worries on the differential impact of capital mobility turned out to be prophetic of demands for a restoration of national

determination. Similarly, international trade deals such as the Transatlantic Trade and Investment Partnership between the USA and the European Union created concern in many quarters that it favours corporations and erodes national autonomy. The post-war regime rested on 'shallow multilateralism', allowing politicians to concentrate on domestic social welfare and employment as global trade recovered—a trade-off threatened by a new form of 'hyper-globalization' that weakened domestic political autonomy.

5 The Labour Migration Versus Labour Protection Trade-Off: Free Movements or Collective Property Rights?

A clear case of this tension is over migration, where businesses want freedom to hire across borders or outsource labour, whereas many workers view citizenship as a collective property right controlled by the nation. The analysis of globalisation in the later nineteenth century by Kevin O'Rourke and Jeffrey Williamson sounded alarm bells for those able to hear them. As they show, the success of globalisation in the later nineteenth century contained the seeds of its own destruction. The movement of people and capital from Europe across the Atlantic meant that wages in the Old World rose, and wages in the New World were lower than they would otherwise be. Migration raised the labour force in the new world by about a third and reduced it in Europe by about an eighth between 1870 and 1914. The result was convergence of incomes between the two sides of the Atlantic. At the same time, the expansion of cultivation in the New World and a rapid fall in transport costs led to export of foodstuffs to the Old World. Consequently, land rents rose in the New World and fell in Europe. Income inequality narrowed in Europe as a result of rising wages and falling rents; meanwhile, in the USA, pressure on wages and increases in rent led to increased inequality. The result was demand for protection by landowners in continental Europe and a demand for immigration control in the New World. As they point out, 'globalization-induced inequality contributed to the deglobalization and autarkic policies that dominated between 1914 and 1950'. Hence, the previous collapse of globalisation was not an exogenous shock from war, but the result of 'a political backlash developed in response to the actual or perceived distributional effects of globalization…. Far from being destroyed by unforeseen and exogenous political events, globalization, at least in part, destroyed itself…. The record suggests that unless politicians worry about

who gains and who loses, they may be forced by the electorate to stop efforts to strengthen global economy links, and perhaps even to dismantle them' (O'Rourke and Williamson 1999, pp. 13–15, 29, 35, 40, 55, 60, 74–75, 91, 93, 105, 113, 145, 163, 166, 167, 169, 177, 181, 183, 283–287).

During the first age of globalisation, movements of labour and capital were connected: most capital exports followed migration to settler economies with scarce labour. In the later twentieth and early twenty-first centuries, capital movements and labour migration are distinct. Not only has labour migration been at a lower rate in the second age of globalisation, but it has a different relationship with capital mobility and does not act as a complementary force leading to convergence (O'Rourke and Williamson 1999, pp. 14–15, 119–120, 145, 165–166; Hatton and Williamson 1998, p. 3). International migration and adjustment of the exchange rate were, to some extent, alternatives, as is clear in Scandinavia. The level of emigration was both high and volatile, operating as 'a vulnerable margin that responded to labor market conditions with a powerful multiplier'. The countries of Scandinavia remained on gold before 1914 and traded almost entirely with other gold countries, so that they could not adjust their balance of payments by modifying the exchange rate either through domestic monetary management or through variations in exchanges with non-gold currencies. Hence, fluctuations in migration provided an alternative adjustment process: when costs were reduced or jobs lost, more people emigrated. In other countries, such as Japan and Russia, emigration was low and was not available as an adjustment mechanism. Britain was somewhere between these two poles, for trade to non-gold countries allowed a degree of exchange rate movement, and there was a reasonably high level of emigration before 1914. Lower emigration after 1914 reduced the availability of an alternative adjustment mechanism (Catao and Solomou 2005, p. 1273; Hatton and Williamson 1998, pp. 19, 67–74).

In the period before 1914, labour migration was probably the single largest factor in wage convergence in the Atlantic economy, surpassing the influence of capital mobility with which it was associated. Globalisation in the late twentieth century was related to a reduction of inequality between rich and poor countries, with lifted many of the world's poorest people out of poverty—yet at the same time, with a widening inequality within the advanced economies as those who gained from financialisation pulled away from those who lost from the decline of traditional industries or outsourcing (Bourguignon 2015). Migration from eastern Europe into Britain, or from Mexico into the USA, was blamed for these wider problems—and of course, poorer people in those countries had good reason to look for better jobs in more

prosperous countries, as before 1914. The result after the First World War was the imposition of labour controls on migration from Europe—and now the attempt to build a wall on the southern border of the USA and to reduce migration into Britain to low levels.

6 Conclusion

There is once again a very real danger that economic nationalism will threaten the global economy. The marriage between global capitalism and liberal democracy seems to be heading for the divorce courts, under the strains of inequality, suspicion at the self-interested behaviour of financial elites who created the crisis and of politicians who failed to prevent it. Increasingly, globalisation is seen as a threat to national sovereignty and identity. The solution is not a flight into economic nationalism with all the dangers that posed in the 1930s. Rather, it is to create a new balance between national democracies and the world economy, sustained by international institutions. As Rodrik remarks, 'A thin layer of international rules that leaves substantial room for maneuver by national governments is a *better* globalization' (Rodrik 2011, p. xix). In September 2016, Mario Draghi of the European Central Bank and Christine Lagarde of the IMF called for policies to help those left behind by globalisation (*Financial Times* 2016; Wolf 2016). The alternative to 'reflex internationalism', as Larry Summers points out, is 'responsible nationalism—an approach where it is understood that countries are expected to pursue their citizens' economic welfare as a primary objective but where their ability to harm the interests of citizens elsewhere is circumscribed. International agreements would be judged not by how much is harmonised or by how many barriers are torn down but whether citizens are empowered' (Summers 2016). The survival of globalisation—from which so many in the less developed countries have gained—demands policies that create a new balance with domestic welfare. The lesson of the Great Depression was that the pendulum swung too far towards economic nationalism and destroyed the international economy with devastating results. The lesson of the Great Recession is that it swung too far in the opposite direction towards hyper-globalisation. The imperative now is to prevent a swing back to economic nationalism. Reconstruction after 1945 rested on 'shallow multilateralism', allowing politicians to concentrate on domestic social welfare and employment as global trade recovered. Could that be the optimum solution? Multilateral institutions are seen by many who have lost from globalisation as agents of those who gained,

and the counternarrative that free trade is to the benefit of most people has been undermined. In Edwardian Britain, support for free trade was redefined by linking it with a policy of redistribution to benefit poorer members of society; at present, the rhetorical strategy that has succeeded has been to blame immigration or outsiders such as Chinese competition or Brussels bureaucrats. The issue, then, is how structural changes in the economy are framed rhetorically. International political economy is a complex mixture of real material interests and cultural appropriations.

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