FINANCIAL JUSTICE IRELAND

How and why did the Bretton Woods institutions emerge?

A 'Plain English Economics' Classroom Resource for Post-Primary Schools

Irish Aid
WorldWise Global Schools

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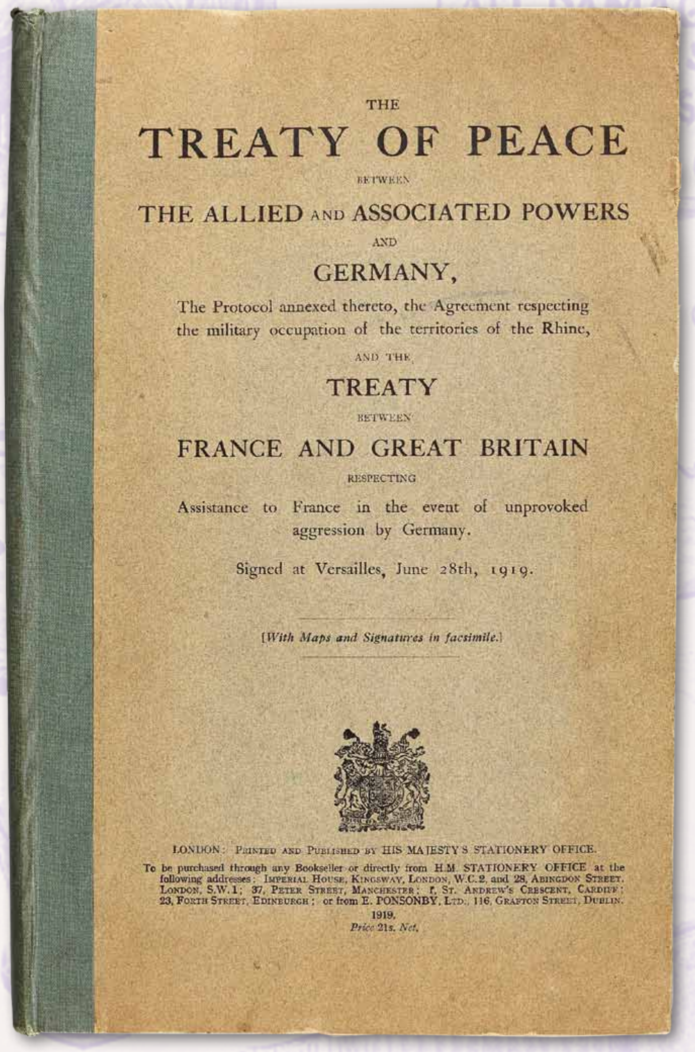
Why this series?

Insights into the international monetary system and effective principles for governing it can result only if it is seen as a historical phenomenon; extending from the gold standard period to interwar instability, then to Bretton Woods - and finally to the post-1973 period.

How a debt trap in 20th Century Germany led to the formation of the IMF and World Bank

World War I and the Treaty of Versailles

The Treaty of Versailles officially ended WWI. The treaty's so-called "war guilt" clause forced the Weimar Republic (modern day Germany) and other Central Powers to take the blame for World War I, and for the Weimar Republic to pay punitive reparations to the Allies, in particular France.


THE

TREATY OF PEACE

BETWEEN

THE ALLIED AND ASSOCIATED POWERS

AND

GERMANY,

The Protocol annexed thereto, the Agreement respecting the military occupation of the territories of the Rhine,

AND THE

TREATY

BETWEEN

FRANCE AND GREAT BRITAIN

RESPECTING

Assistance to France in the event of unprovoked aggression by Germany.

Signed at Versailles, June 28th, 1919.

[*With Maps and Signatures in facsimile.*]

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1919.

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After the war, in 1919, the US (and Britain) suspended the Gold Standard.

The Roaring '20s

A post-war euphoria was witnessed in the United States - the 'roaring 20s' was a consumer driven, credit-based economy that led to huge risks being taken in Wall Street. Risky loans that were unlikely to be repaid were given out by bankers, so that bankers could get rich off the interest paid on the loans. (This is one of the ways banks could make money.) Eventually, this bubble burst as debtors (those with debts to pay) could not repay their big loans. This culminated in the 1929 Wall Street stock market crash, where panic caused a rush to sell stocks and prices of stocks then plummeted.

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WALL STREET CRASH!

Black Thursday in America

Stocks Plunge and Eleven Commit Suicide

Panic selling hit the New York Stock Market yesterday as nearly 13 million shares changed hands in just one day.

Massive sales in the early morning created an extraordinary atmosphere of chaos and panic. Brokers flooded the market with orders from their investors to sell at any price.

As the situation reached crisis level, the market broke down entirely as the sea of brokers clamoured madly for non-existent buyers. Stocks were traded for any price and the value of some companies halved during the course of the morning.

The huge early morning sales followed a week of uncertainty on Wall Street and the bottom finally dropped out of the market at 11.30am, when the ticker tape was no longer able to keep up with the sheer volume of activity.

Crisis Meeting

A crisis meeting of New York's leading bankers was held in the offices of JP Morgan & Co and prices recovered slightly in the afternoon on the assurance from the firm's senior partner, Thomas W. Lamont, that the problems were 'technical rather than fundamental'. With masterly understatement, Mr Lamont admitted that: 'there has been a little distress selling on the Stock Exchange' but the most influential financiers in New York concluded that the market was essentially safe and was simply readjusting after four strong years of growth.

In an attempt to defuse the crisis, the Treasury in Washington also issued a statement to the effect that general business was still fundamentally sound and that the vast losses affected mainly paper profits only. The reassuring nature of the statement was, however, undermined by intimations from Treasury officials that proposals to cut taxes next year would be abandoned unless the Stock Exchange rallied.

Riots

Despite the rallying-round of the great and good, the day's activities saw thousands of businessmen ruined and police riot squads were forced to enter Wall Street to disperse the crowds of hysterical bankers and investors. The late recovery in some prices was not sufficient for many of those bankrupted by what is already being called The Wall Street Crash. Eleven speculators were believed to have committed suicide.

Panicking investors gather around the statue of George Washington

What Went Wron

The initial massive sale of stocks began when it became clear that a downturn in some major industries was expected, mainly because of overproduction in the very competitive automobile industry.

Once the panic began, the situation simply grew out of control as nervous investors all tried to shed their plummeting stocks at the same time.

Chaos

The all-consuming chaos was, in part, blamed by bankers on the inadequacy of the old ticker-tape system in processing such enormous volumes of trade. By the end of the trading day, the ticker recording Stock Exchange transactions was over four hours behind the trading which had taken place.

Telephone facilities were also totally deficient during the crisis, not only in Wall Street but also throughout the

Since the end of the depression of the early

by Black Thursday.

Financial Reports - p11

OTHER NEWS

London Buses to be Red - The Government announced that all buses in London will be red. The decision follows the recent trial of a red and yellow version of the new bus, which failed to win popular support. **p10**

New Government in France - The appointment of a new government is expected in France, following the resignation of the government of veteran statesman, Aristide Briand, on Tuesday. **p4**

Yugoslavia is Born - The new official name of the Kingdom of Serbs, Croats and Slovenes will be 'Yugoslavia', it has just been announced in Belgrade. **p7**

This provoked the Great Depression. A 'Depression' means a prolonged period of economic contraction. People lost most or all of their savings. Unemployment increased and many people had to declare bankruptcy. At this time there was also a trade war as the United States attempted to promote its own goods by taxing imports. This triggered what is known as a 'deflationary spiral'.

Under normal circumstances, having high employment means there is high demand for goods and services; high demand keeps the prices of goods high enough for businesses to make enough money to stay open. However, in the Great Depression unemployment increased, which meant that demand dropped, which meant that the prices of goods had to be lower, which meant less income for businesses, which meant less money for wages (given that profits support employment), and so on. To make matters worse, with less wages, it meant there was less tax going to the government. This meant less money for the government to support people and pay for public services. That meant less opportunities for employment. In these situations, people tend not to spend money because they are a) worried about losing their job and b) watching how prices are dropping and waiting to get the best bang for their buck! This further reduces demand.

Watch **this** video for a thorough explanation.

Unregulated capitalism and greed were held responsible.

At the same time ...

Moving across the water, let's look at what the Wall Street Crash did to Germany (then called the Weimar Republic). Germany was already poor as a result of the punitive reparations it was required to give to other countries after WW1 (as enshrined in the Treaty of Versailles). This meant they had to borrow lots of money. They borrowed from the USA. The Depression had a huge impact on Germany (again, it was then called the Weimar Republic), because the US, as it was struggling so much, called in its loans. The reason for the financial collapse was Germany's large pile of foreign debt which was in gold currency.

This forced the government to cut spending, raise taxes, and lower wages in the middle of a worldwide recession brought on by the 1929 Crash. The German industry lost finance and lowered its production (supply). It had to let many workers go as it couldn't pay them. And as more people became unemployed, the less money they spent (demand fell). This then led to prices of goods dropping. Sounds familiar? This was another deflationary spiral in action, only this time in the Weimar Republic.

US calls in loans

↓

Geraman industry loses finance, lowers production, lays off workers

↓

People spend less, prices drop, demand fails

↓

Industry loses more money, lowers production further, lays more workers off

↓

People spend less, prices drop

↓

Depression

Source: BBC

In three years, German production halved. Thousands of small businesses collapsed and unemployment rose to over 6 million. A third of the population had to be supported by social welfare. In the face of the Depression, and with German democracy collapsing, the German people looked for new solutions.

As the political resistance to this austerity policy grew, the German government began to question its debt obligations, wondering if it should pay. This prompted foreign investors to panic and sell their German assets, further weakening the German economy.

Hitler profited from the crisis, rising to power in 1933, largely because he had been the most vocal critic of the reparation regime. As the financial system collapsed, his populist attacks against foreign creditors and the alleged complicity of the existing German government resonated more than ever with the electorate who were feeling the cold wind of austerity policies (cutting spending and increasing taxes).

Perhaps, if those to whom Germany had owed money gave them debt relief, Hitler might not have had such an opportunity. In three years, the Nazi Party went from 12 seats in the Reichstag to 230 seats in 1932, or 42%. They went into power because of deflation, not inflation!

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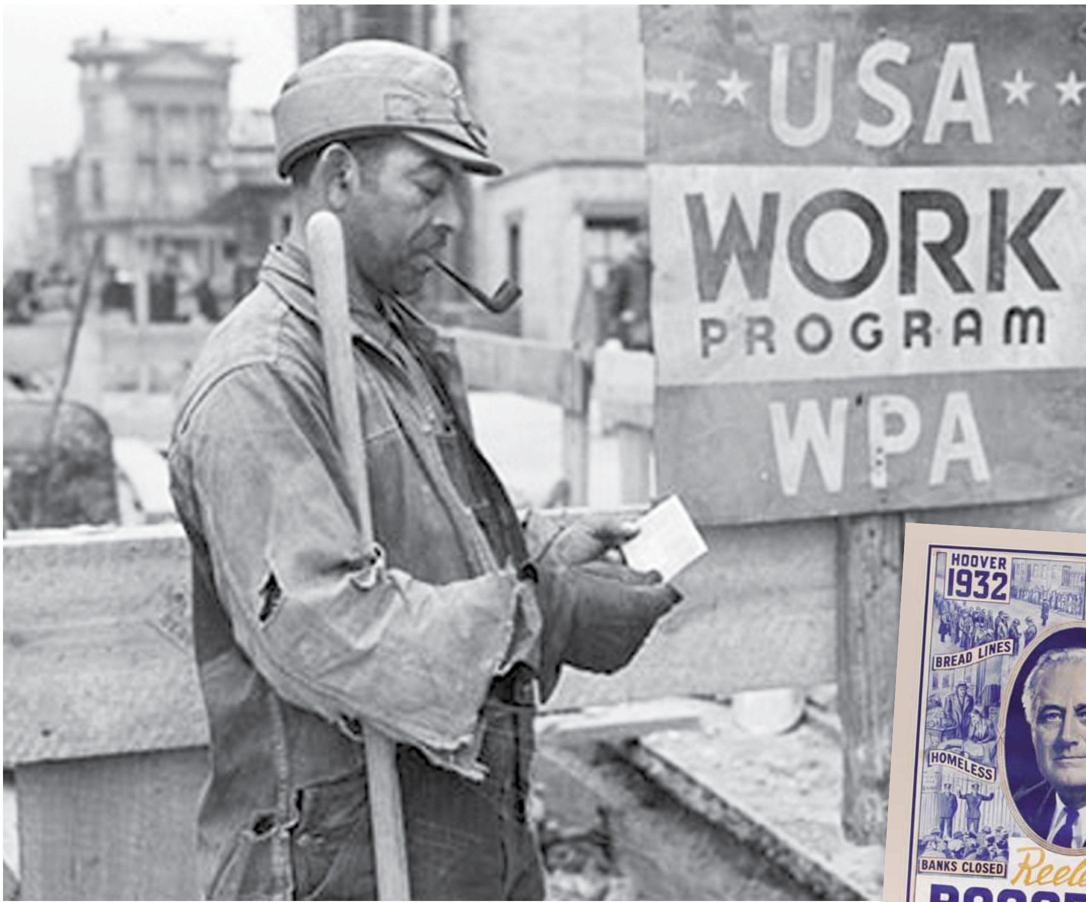
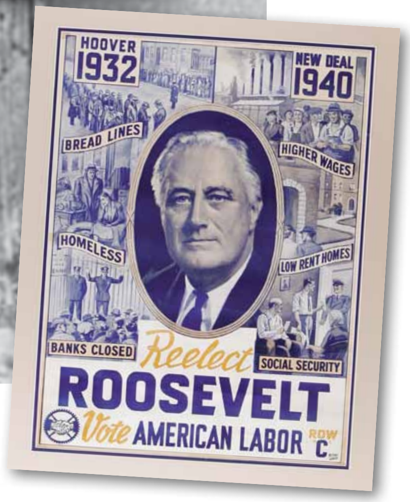
The New Deal

Back to the US: The Depression led to massive political change in the USA as Franklin D. Roosevelt was elected in 1932. The US came off the gold standard, meaning that banknotes could no longer be exchanged for gold - they were no longer 'fixed' to gold at a 'fixed' exchange rate.

His administration began to implement the 'New Deal'. This was a series of infrastructural reforms, financial regulations, public work projects and labour-promoting projects across the US between 1933 and 1939. There was heavy state involvement, lots of redistribution of money to help improve living standards, and generally lots of public investment. This has been described as an attempt by capitalist leaders to address some inequality issues in order to try to win the 'battle of ideas'. It is important to remember that at this time, the Soviet Union, which was communist, was very strong.

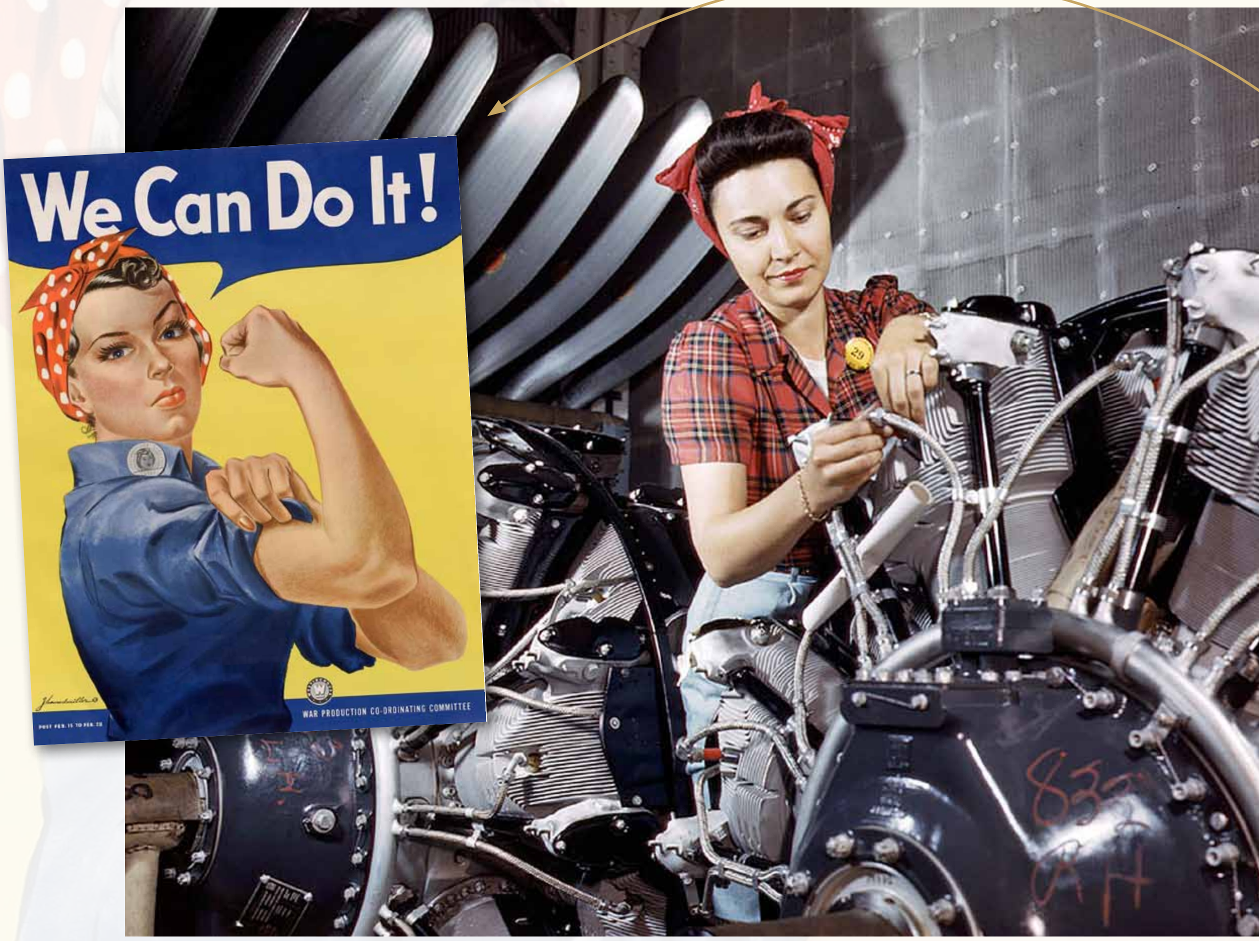




WWII

Ironically, the war effort in the USA massively transformed the economy, and it was this effort that brought the USA out of its depression. Industrial production skyrocketed. Many women were brought into the workforce because so many men were fighting in the war (look up Rosie the Riveter!). The power and necessity of labour allowed labour unions to gain power. What's more, taxes needed to be raised in order to pay for the war effort, so inequality diminished in the USA as those earning higher wages were taxed at a higher rate.

WWII caused a huge shift in wealth and income inequality. "In the face of death, we are all equal" (however this was still in a society stratified by race, gender, sexuality and other identities). What's more, power relations changed as governments needed to source revenue from many sources, something that was very different in pre-WWI aristocratic Europe and USA. The social landscape changed and a benefits system was created; public intervention, state support, nationalisation of industry, high taxation of property and wealth. Capital, anything that can be privately owned, was restrained, and instead of the goal being capital accumulation, now it was the harnessing of capital for public benefit. Capital is now seen as something that should be used for the people, not something for the rich.



Rosie the Riveter

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The Bretton Wood Institutions

After the war, there was literally no functioning global economy, so the Allied nations (the US, the UK, France, Canada and Australia) got together to create a new trading system and a new monetary system. That monetary system was devised at a three-week conference in a town in New Hampshire in the USA called Bretton Woods - hence it was called the Bretton Woods Agreement. One of the key elements was that the dollar would be pegged to gold at $35 an ounce. Other central banks could exchange the dollars they held for gold. So dollars could be exchanged for a value of gold, and this was fixed. This is why it is called a 'fixed exchange rate system'. Every other currency had a fixed exchange rate to the dollar, and therefore to gold. The dollar became the global currency. Everyone was happy to hold it, in large part because they could exchange it for gold if they had any doubts about its value. It was part of the phenomenal recovery from the war in Europe and Japan. It also created enormous economic prosperity in the U.S. throughout the '50s and '60s.

Bretton Woods
Carrol, New Hampshire, United States

Preceding instability prompted an extensive global political consensus around the need for international financial stability. The institutions brought in strict limitations on how much foreign currency could be brought into and taken out of a country, as the capital flight of foreign assets in Germany compounded the austerity.

At the end of the conference, the United States dollar replaced the gold standard as the global currency, essentially making the United States the most powerful country in the world. The IMF and World Bank for Reconstruction and Development (now just called World Bank) was set up to monitor this new system.