

Post-war liberal international economic order



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John Maynard Keynes, a British economist argued the necessity for a new economic system. Keynesian economics rejected the fixed rate gold standard in favour of a fluctuating exchange rate. Keynes also called for an international bank to prevent another economic crisis. He argued for mild protectionism both nationally and internationally. In order to argue how the post-war liberal international economic order fell into crisis it is vital to understand the components and function of the economic system. This new economic order had defining characteristics which consisted of embedded liberalism, in which it was argued that liberal trade promotes economic growth. Another characteristic of this new order is multilateralism, where a number of countries combine efforts, in this case was the establishment of organisations within this new economic system. Present at Bretton Woods, both John Maynard Keynes and Harry Dexter White argued their ideas for the new economic arrangement, ' Keynes and White also favoured capital controls in order to preserve a stable international exchange rate system and liberal trading order'. The aims of the Bretton Woods conference were to negotiate a new economic order which would govern monetary relations among independent nation states. It was also established to rebuild the international economic system, set up a system of rules, institutions, and procedures to regulate the international monetary system.. 29 countries were present to sign the articles of agreement at the Bretton Woods conference. However, ' Keynes plan was never discussed seriously at Bretton Woods and the participants agreed on the White plan'. Finalised in 1947, in Cuba, under Bretton Woods agreements it was decided that gold was to be pegged at \$35 per ounce. This meant that every other currency was fixed to the US dollar.

Another institution established was the international monetary fund. This was designed in order to aid states maintain fixed rates of exchange. This fund is paid subscriptions annually from member countries in which is used to aid countries struggling to pay the balance of payments deficit. It would also find solutions to problems such as the convertibility of currencies and any financial issues within the globe. The idea was that nations with persistent deficits were to be given overdrafts in order to help the nation's economy which acted as a safety net for the world economy. IMF approval was required change in exchange rates. It also was established to advise countries on policies affecting the monetary system. The IMF main objective was to control inflation and to introduce strict plans. This meant that the divide between the north and developing south grew. It shows that the liberal economic order was only of benefit to western countries. This was detrimental to world economy as developing countries continued to borrow from the international bank for reconstruction and development to pay balance of payments, instead of reinvesting it within their economy.

Another institution established under this agreement was the international bank for reconstruction and development. The aim of this institution was to aid the rebuilding of Europe from the devastation caused by the war. It had been recognized in 1944 that the new system could come into being only after a return to normalcy following the disruption of World War II. It was expected that international economy would recover. It was also expected to promote the growth of world trade and to finance the reconstruction of Europe. The IBRD had an authorized capitalization of \$10 billion and was expected to make loans of its own funds to underwrite private loans and to

issue securities to raise new funds. Another policy established was the general agreement on tariffs and trade. This encouraged trade between nations by regulations and reductions. It also served as the supervisory body should any trading disputes arise.

The new liberal economic order as a whole possessed its weaknesses which can be argued helped to contribute to the crisis during the 1970s, ' The Keynesian paradigm was not what it seemed to be. It was not all that easy to manage the economy by wielding the levers of fiscal policy'. Firstly individuals disagreed with the foundations of Keynesian economics. Both Milton Friedman Robert Lucas formed different arguments which argue the system was bound to hit crisis. Firstly, it is argued that government intervention ranges from ineffectiveness to damage to the economic system. Instant information of any recession is available freely through information technology such as computers and through the means of the media. This would consequently that before any international institution has time to react, businesses could react which could end up having a detrimental effect on the economy. Furthermore it is believed that recessions eventually recover themselves and that the market naturally takes steps in order to improve without any need for outside intervention. Out of this debate, monetarism was recognized in which would argue that the market has the capabilities to adjust itself to combat inflation and unemployment and that governments role should be to inject a steady amount into the economy and sustain money supply. Another weakness within this system was the failure to predict the onset of decolonisation and rising nationalism. This process witnessed many states around the globe gain independence from their

previous colonial occupiers. When the Bretton Woods agreement took place, only the members of the United Nations signed the articles of agreement. However the number of countries within the international system increased dramatically, especially after the fall of the traditional empires and the collapse of the Soviet Union. These newly established countries needed to be considered within the new economic reform. Additionally, with such a radical change in economics, a hegemonic state is fundamental in order to sustain this change. However the leading economic powers were unwilling to accept the demands and constraints on their macro-economies that are required to make such a system effective.

Robert Triffin, an American economist had acknowledged a weakness within the Bretton Woods system. The number of U. S. dollars in circulation outweighed the amount of gold in reserve. The reason why the US was the hegemonic state was because it was the most promising and stable economic state however, the 1960s saw a change in the value of gold. An ounce of gold could be exchanged for \$40 in Britain, even though the price was pegged at \$35. This shows the dollar was overvalued. There was a solution to this dilemma. As the US acted as the hegemonic state, all currencies were centred on the dollar. This idea proved to be detrimental to US economy, 'growing US balance of payments deficit meant that foreign governments were accumulating large amounts of dollars- in aggregate volume far exceeding the US government's stock of gold'. During the 1960s demand for the dollar became low as countries were unwilling to accept the high inflation rates. This consequently meant that because reserves of the dollar were low, the US sought an inflationary policy and set a limit on the

convertibility of the dollar. This could be argued was a weakness of the Bretton Woods system.

The reasons why the dollar suffered can be put down to a few reasons. Initially, the US foreign policy was set on the destruction of communism and with money being invested to prevent the spread of the ideology, 'the US pledged economic and military resources to confrontation of the Soviet Union'. US funds were also used to help rebuild Western Europe and Japan in form of the Marshall Plan. The aim of this plan was to prevent countries turning to communism, to bring prosperity and to avoid another war. The economic repercussions from the Vietnam War 'economic burden of war contributed to the destabilisation of the American economy that led to the stagflation of the 1970s', the American population were hit hard with a steep rise in taxes in order to pay for the War which had repercussions on inflation and a balance of payments crisis. Not only did the cold war have a profound impact on the economy of the US, but all the countries involved suffered, 'cold war rivalry fed the flames of local conflicts, contributing to escalation violence and increasing poverty'.

The emergence of oil was important in explaining why the post-war liberal international economic order fell into crisis during the 1970s, 'The oil embargo which accompanied the 1973 Yom Kippur War between Arabs and Israelis, delivered a terrific shock to the economy'. The 'seven sisters' held a monopoly over oil in the Middle East and collaborated in order to set low prices and maximise their own interests over those of the oil producing states. The Organization of the Petroleum Exporting Countries (OPEC) is a permanent was created in order to counter act the exploitation. With <https://assignbuster.com/post-war-liberal-international-economic-order/>

technological advancements and a growing reliance on the natural resource, oil producing countries began to realise they were being exploited by Western powers and wanted to reverse this process. OPEC decided to use the production of oil as political leverage in form of their foreign policy. The price of oil increased in 1973 from \$1.40 to \$5.90, this was eventually raised to \$11.60. The sharp escalation of oil prices inflicted an energy crisis within both the US and Western Europe who were dependent on Middle Eastern oil for their energy sources. Although the US had oil reserves, the prices hit Western Europe hard and helped to contribute to explain how the post-war liberal international economic order fell into crisis during the 1970s.

In Conclusion, the reasons why post-war liberal international economic order fell into crisis during the 1970s are under much scrutiny. It was believed that markets could self-recover without the need of international institutions. The fall of the US as a hegemonic power also contributed to the reasons why the order fell into crisis. With repercussions on the currency from the Marshall plan, the cold war and the Vietnam War, America seemed to be involved more in foreign than domestic policy. The final reason why the order came to crisis was the effects of the oil crisis. Oil producing countries realised western countries reliance on the natural resource and were therefore able to use this as a political tool. More importantly, It can be argued that the system established at Bretton Woods was weak and too regulated, 'the system was too rigid, too slow, too distorting ... it denied markets the salutary effects of competition. It froze relationships, shored up cost levels, and, of critical significance, institutionalised inflation'.