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A Scholar in Action in Interwar America. John H.Williams' contributions to trade theory and international monetary reform

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**Abstract -** In this paper we analyse the scientific contributions of Harvard economist John H. Williams as international trade theorist and monetary reformer, together with his activities as a Vice President of the Federal Reserve Bank of New York. In the first two Sections we present a succinct overview of Williams' main contributions to international trade theory and to the interwar debate on the reform of the international monetary system. Particular attention will be devoted to his early academic writings which contained different critical arguments against the two main tenets of classical international economics: the Ricardian theory of comparative advantages and the gold standard. These criticisms formed the theoretical rationale and the analytical background of Williams' key currency approach to the reform of the international monetary system. The key currency plan was first formulated when Williams advised Roosevelt and Morghenthau to sign a Tripartite agreement with Britain and France, and was later refined during the negotiations which concluded with the approval of the Bretton Woods agreements. In this respect, Section 4 is devoted to the analysis of the contents of Williams' proposal and to the reconstruction of his main criticisms of the two official plans presented by John Maynard Keynes and Harry Dexter White. Section 5 is devoted to examining Keynes' and White's reactions and to elucidating what aspects of Williams' ideas managed to influence the shaping of the Bretton Woods Agreements. Finally, Section 6 presents some general conclusions. Sections 4 and 5 have greatly benefited from the use of archival sources which have been quoted at length, mostly in the footnotes

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## 1. Introduction

Interwar economic events were a powerful source of inspiration for those economists who studied the relation between theory and current problems with a view to prescribe original solutions for policy authorities. If we examine the Presidential addresses at the annual meetings of the American Economic Association, we realize how the difficulty in reconciling past economic doctrines with the events which were profoundly disturbing the working of the international economic system was frequently deplored.[3] Many scholars denounced that the inherited corpus of economic theories – particularly those which were based on systems of universal laws – was inadequate and misleading. Others enquired whether the causes of economic maladjustments could exclusively be grouped in the short term of cyclical fluctuations which characterized the transition between equilibrium positions. Still others, more pragmatically, believed that the major imperfections lay with economic policies and the institutional framework which needed to be profoundly innovated and redesigned.[4]

In the Usa, this challenge to orthodoxy was cultivated by at least two distinct groups of professional economists. The first assembled those who, since their education and formative studies, began to show a strong preference for the study of international economic problems. From this perspective, the War together with the new international role acquired by the United States in the management of world economic and financial affairs, had provoked a blossoming of research activities in the fields of international monetary reforms, trade integration and stabilization policies. These were subjects which – with few exceptions – had been traditionally neglected by the most authoritative exponents of US economic thought, since the foundation of the American Economic Association. On the other hand, a powerful movement towards the elaboration of new ideas, techniques and policy proposals came from those scholars who, at some juncture of their academic career, had the opportunity to serve within the public administration. Also from this side, in the Usa the War had greatly increased the demand for economists as Government consultants and policy advisers. Their successful performance as members of public boards, think tanks and research institutes, had paved the way for more systematic exchanges and marked the beginning of a new era which was characterized by a proliferation of economists "in the public service". Brilliant professional accomplishments were also achieved because the group was led by some of the most eminent authorities in the fields of money, trade and finance: Irving Fisher, Frank Taussig and Wesley Clair Mitchell were among those who most vigorously encouraged younger colleagues to follow their tracks as economists in the public service.[5]

After the 1929 crash, this new breed of "international scholars in action" made important contributions to the growth of US economic thought, favouring the opening of new fields of enquiry and the establishment of new research methods. As recent interpreters have argued, the creation of new professional opportunities in the fields of international economics and economic policy advice contributed significantly to the triumph of pluralism in US economics.[6]

Together with Edwin Kemmerer, Parker Willis, Jacob Viner and a few others, John H. Williams shared both these qualities. He was certainly one of the most prominent international political economists of the interwar years, with a profound knowledge of classical economics together with a strong preference for applied studies and the inductive verification of inherited theoretical models. Williams was also a renowned authority in monetary reforms and international finance, combining theoretical expertise with a strong bent for the practicalities of the everyday

[3] See, among other, Fisher 1919; Mitchell 1925; Fetter 1925; Kemmerer 1927.
[4] Standard references are: Dorfman 1949-1957; Stein 1969; Davis 1971; Morgan – Rutherford 1998; Rutherford 1998.
[5] The expression is drawn from Fisher 1919. See also Coats 1992 and 1998; Asso 1994; Barber 1998.
[6] General reference: Morgan – Rutherford 1998; Rutherford 1998.

world. It was in the fields of international trade and finance that as a young economist he began to act as adviser to policy authorities.

Throughout his life John Henry Williams was a man of two careers.[7] He studied at Harvard where, in 1919, he completed a Ph.D under the direction of Frank Taussig. His dissertation, on the Argentine balance of payments, was published by Harvard University Press and provided one of the first critical accounts of the classical approach to the Balance of Payments adjustment. Until 1925, Williams held temporary teaching positions at Brown, Princeton and Northwestern Universities, before he returned to Harvard as Associate professor of Economics. There he gained a full professorship in 1929 and, in 1947, was appointed as the first Dean of the Harvard Business School. As an economist in the public service, Williams' career started in 1918 as Assistant in chief at the Dept of Commerce.[8] After a brief experience as Research economist at the American Bankers Association, on 1 May 1933, Williams joined the Federal Reserve Bank of New York as an expert in international monetary affairs. While retaining his professorship at Harvard, he became an assistant Federal Reserve agent.[9] Three years later he acquired a senior administrative position as vice-President and Research Director. At the New York Fed, Williams introduced a vast number of proposals for the reform of the domestic and international monetary system and fought hard to modernize the art of central banking after the poor performance exhibited by the federal monetary authorities during the depression. His professional life ended in the 1950s, when he held advisory positions in the US post-war commission on Foreign economic policy and in the US Economic Corporation Administration in Paris.

Several interpreters have already recognized Williams' originality as an international economist who made innovative contributions to economic thought and policy.[10] In this field, Williams remains well known for his early studies on the structure of the American Balance of Payments,[11] for his critical interpretation of the classical theory of international trade,[12] and for his unconventional analysis of the international gold standard.[13] The intense research activity which Williams conducted in these areas gave him a focus on the importance of macro-structures, economic history and empirical verification of established theoretical doctrines which he never lost throughout his life and deeply influenced his activities as a public servant and monetary reformer.

As an economist in the public service, Williams started as an assistant to Herbert Hoover at the Department of Commerce. There he was commissioned to prepare reliable statistics on the US Balance of Payments, with particular responsibility for recent developments in capital transactions and the "invisible" items. As William Barber has observed, "in the history of the statistical work of the Federal government, this was a signal event. It marked the first occasion on which government itself generated the primary data, as opposed to relying on private organizations to supply them" (Barber 1985, 206, fn. 83). At the New York Fed, Williams began to get deeply involved in the study of monetary affairs, an area that soon fascinated him and was to remain a major interest

[7] For Williams biography see Duesenberry, Lintner and Mason (1983).
[8] He worked in the Latin America division.
[9] Between 1932 and 1934 Williams also acted as US delegate at the World Economic Conference and participated to a Department of State Mission to investigate Latin American exchange problems.
[10] See among others Clark 1977; Cohen 1998; De Cecco 1976; Fishlow 1989; Gardner 1980; Flanders 1989; Ikenberrry 1992; Rowlands 1976. We are particularly indebted to Marcello De Cecco who, in many of his works, has often recalled the importance of Williams' ideas. His 1976 article on Us domestic and international financial markets since 1945, has a rather strong *incipit*: "This is an essay in the anti-Ricardian tradition of J. H. Williams" (De Cecco 1976, 381).
[11] In 1919 Williams contributed with Charles Bullock and Rufus Tucker a pioneering and descriptive study on the history of the US Balance of trade from 1789 to the end of the War [See Bullock, Tucker and Williams 1919]. In the following years Williams published regular updates of this work.
[12] Williams 1920b and Williams 1929.
[13] Williams 1932a, 1932b and Williams 1934.

throughout his life. According to his own private records,[14] between May 1933 and May 1954, Williams produced almost 200 pieces – mainly memoranda to the governors, bank committees or other parties but also reports, legislative proposals, and statistical enquiries. The subjects of Williams' activities ranged widely from monetary and exchange rate policy to domestic banking policy and reform. Historians have studied Williams' activities at the New York Fed. We include two recent references: "in the contributions of Williams more than anyone else", David Laidler has found evidence in support of the pervasiveness of an early 1930s Chicago tradition in monetary economics.[15] In his very authoritative and monumental biography of the Federal Reserve, Allan Meltzer has confirmed that Williams contributed to shape Federal Reserve monetary policy: he had "considerable influence on policy throughout [his] long career at the Federal Reserve and was an ardent proponent of international coordination".[16]

However, it is also well known that the most relevant portion of Williams' activities at the Federal Reserve dealt with the elaboration of plans for international monetary stabilization. In particular, Williams' writings have been considered as originating the so called "key currency approach" to the reform of the international monetary system. Peculiar to the "key currency approach" is the suggestion that the world can be hierarchically divided into countries, regions and currencies which are characterized by unequal economic size and importance.[17] On the contrary, established doctrines – like the Ricardian theory of comparative advantages or Hume's price–specie–flow mechanism and, above all, the conventional interpretation of the classical gold standard – were based on the flawed principle of homogeneous countries and perfectly symmetrical markets which found no correspondent in the real world. On these grounds, Williams thought that the preliminary condition for restoring stability and optimality in the post-war monetary system was to redesign the responsibility of key countries and set new rules for their currencies. The idea of key currency was also rather influential to the development of plans for monetary reforms based on a restricted number of countries or on a variable speed of participation. Among others, Robert Mundell has acknowledged the importance of Williams' writings in a paper devoted to the reconstruction of his optimum currency areas.[18]

By the mid-1930s the "key currency approach" was introduced for the first time in the diplomatic agenda.[19] In close co-operation with the Taussig group of international economists who had by that time joined the Roosevelt administration (most particularly, Jacob Viner and Harry Dexter White), Williams strongly advised Treasury Secretary Henry Morgenthau to start informal discussions with France and Great Britain to re-establish some form of co-operation and stable relations in the management of exchange rates. Following these conversations, in 1936 the three countries signed a Tripartite Agreement which operated as a daily fixed exchange rate system between their respective currencies.[20]

Subsequent developments of the key currency idea led Williams to become the most authoritative voice against the two official plans which formed the intellectual backbone to the Bretton Woods agreements. Williams wrote the most influential "third" plan that appeared in Spring 1943, at about the same time that the White and Keynes plans were published and became the

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[14] Archives of The Federal Reserve Bank of New York, Williams papers.
[15] Laidler 1993. See also Tavlas 1997.
[16] Meltzer 2003. On several other issues Meltzer finds that Williams' writings deserve particular attention. His critical essays on the first wave of proto–Keynesian models "anticipated major controversies about the effects of government spending, deficits and debt in the 1960s and 1970s" (Meltzer 2003, p. 610).
[17] See, on this aspect, Cohen 1998.
[18] Mundell 1997.
[19] See Williams 1937.
[20] Clark 1977. As Meltzer (2003, 540 and 545) notes, the importance of the Tripartite agreement was "more symbolic than substantive… as a political measure the agreement had greater merit".

object of official negotiation. In a series of articles which were published in professional journals and in *Foreign Affairs*, in his activities at the New York Fed as well as in Congressional hearings, Williams raised a number of critical concerns against the proposal for the establishment of new international monetary institutions.[21] His views received a wide audience and elicited comments and replies from several economists in Government. His opposition created serious conflicts within the Administration and between the US Treasury and the Federal Reserve.

Williams' plan took the name of the "key currency plan". Since its beginning, the main target of his campaign was White's scheme for an International Stabilization Fund. Williams was particularly concerned about its technical functions and for the likely consequences of its failure on the post-war economic and political order. He believed that the new spirit of universal multilateralism had to be supported by the stabilizing role of hegemonic powers. Rather than an outright alternative to White's scheme, his approach was conceived as a preliminary, more realistic step before post-war reconstruction was completed and the prospects for multilateral convertibility were put on more solid foundations. In the meanwhile, the "key currency plan" was meant as a challenge for the strong and hegemonic countries to recognize and to assume their responsibilities before the effective launching of new world organizations.

While some scholars have argued that the Harvard boys under Frank Taussig in the 1930s were as influential as the Chicago boys under Milton Friedman in the 1970s,[22] Williams' role in the discussions and negotiations of the post-war international monetary system has been unduly neglected. Many have dismissed it with the observation that, for different reasons, Williams' key currency plan was soon brought into a blind alley: first, unlike the 1920s, the Federal Reserve now held a modest, insignificant role in international monetary affairs and diplomatic negotiations. After the depression, the wave of bank failures and the 1935 banking reform, central bankers in America had lost most of their power in monetary policy while responsibility in international negotiations rested firmly in the Treasury's hands.[23] Second, Williams himself was initially involved in the discussions of the Economic and Financial Group at the Council for Foreign Relations which provided much of the intellectual background to White's plan. Headed by Jacob Viner and Alvin Hansen, Williams was soon obliged to drop out from the Council because of his firm advocacy of an alternative plan.[24] Third, most delegations at Bretton Woods never seriously considered Williams' counterproposals as part of the diplomatic agenda which eventually elaborated the final Articles of Agreement.[25]

However, this is only partially true. As we shall see in this paper, Williams actively participated to the discussions and, to some extent, managed to influence the evolution of the drafts which eventually brought to the Joint Statement of Experts and to Bretton Woods. Since its first publication, Williams' proposal gained some support within influential financial and intellectual circles – particularly among New York bankers and the leaders of small and open economies. Perhaps due to these circumstances, in the most crucial stages of the negotiations, Williams had two long meetings with Keynes at the New York Fed. Detailed minutes of these meetings were kept by a Federal Reserve economist and by Williams himself and provide a full, sometimes vivid, account of the group of experts at work. Also this episode has already been mentioned in the literature on

[21] The standard reference, where most of these pieces are collected, remains Williams 1949.
[22] Liu 2002.
[23] One could add that the relative decline of power of the New York Fed was even more pronounced. See, again, Meltzer 2003.
[24] As stated in an interview of William Diebold Jr., research secretary for the Economic and Financial Group and quoted by Ikenberry 1992, 301. See also Shoup 197???.
[25] See, among others, Horsefield 1969; Ikenberry 1992; Skidelsky 2000; Meltzer 2003. In a recent article Bordo and Schwart have wondered – counterfactually – what would have happened to the international monetary system had the key currency approach been preferred to White's International Stabilization Plan.

the making of the Bretton Woods Agreements, even though one of its most detailed accounts has downplayed its importance.[26] By contrast, our examination of the full minutes of these meetings – together with other archival materials – will lead us to argue that Williams' views managed to exert some "conditionality" on the final articles of agreement ratified at Bretton Woods in 1944. We shall also show how Keynes himself agreed with many of Williams' critical arguments and how the "key currency" idea can be considered a part of the architecture of the post-war international monetary system. Again, Allan Meltzer has recently strengthened our valuation that "as the system developed, Williams' proposal for an international system based on the dollar soon supplanted many of the features of the Keynes – White plan" (Meltzer 2003, 585).

In this paper we first intend to investigate the analytical background of Williams' key currency approach to the reform of the international monetary system. In this perspective, Sections 2 and 3 present a succinct overview of Williams' main contributions to international trade theory and to the interwar debate on the reform of the international monetary system. Particular attention will be devoted to his early academic writings which contained different critical arguments against the two main tenets of classical international economics: the Ricardian theory of comparative advantages and the gold standard. These criticisms formed the theoretical rationale of his key currency proposal. Then, in Section 4, we analyse the contents of Williams' proposal and reconstruct his main criticisms of the two official plans presented by John Maynard Keynes and Harry Dexter White. Section 5 is devoted to the examination of Keynes' and White's reactions and to the elucidation of what aspects of Williams' ideas managed to influence the shaping of the Bretton Woods Agreements. Finally, Section 6 presents some general conclusions. Sections 4 and 5 have greatly benefited from the use of archival sources which have been quoted at length, mostly in the footnotes.

## 2. Williams' criticism of international trade theory

According to Williams, since the first industrial revolution, international trade and integration played a crucial role in determining the rate of economic growth and technological change, as well as the cyclical downturns and the spreading of depressions.

As many other thoughtful international economists who had worked under Frank Taussig's supervision,[27] Williams moved from the presumption that the pattern of comparative advantages did not tell the whole story in international productive specialization and the evolution of the patterns of trade. He also believed that, only under very specific conditions, terms of trade variations and nominal price changes represented the most important variable in the adjustment process of the economic system to external shocks. Starting from these premises, Williams' critical appraisal of the classical theory of international trade was based on four issues which were meant to undermine both its methodological foundations and the peculiar nature of its essential assumptions.

### *2.1 On method*

Having acquired a very critical attitude toward Ricardian economics from the reading of Walter Bagehot and Thomas Cliff Leslie, since his early writings Williams disputed the pretension of universality which characterized classical economic laws.[28] As a methodological device for theoretical exposition, Williams was convinced that the classical approach retained some usefulness

[26] Van Dormael 1978.
[27] Perhaps, this group produced on these topics the most impressive collection of PhD dissertations in the history of economic thought. The most wellknown, besides Williams 1920, were: Graham 1921-1922 and 1923; Viner 1924; Angell 1926; White 1933.
[28] "As a graduate student nothing interested me more than the writings of the heretics" (Williams 1948, 3).

and validity, even though it had severe limitations if applied to such post-war problems as German reparations or currency instability (Williams 1920a). Perhaps, it was also the proximity with Schumpeter at Harvard and his personal friendship with Jacob Viner, which led Williams to extend the dangers of a Ricardian vice to the mainstream tradition of international economics. In fact, as many contemporary inductive verifications confirmed, the classical theory of international trade was based on very restrictive assumptions which ruled out the really dynamic forces at work. In his view "the classical theory assumes as fixed, for purposes of the reasoning, the very things which in my view should be the chief objects of study if what we wish to know is the effects and causes of international trade" (Williams 1929, 24) .[29]

Historically, Williams believed that the international transfer of productive factors – mainly capital, labour and entrepreneurship – had played a paramount role in the long-run cumulative changes of the industrialized world which the comparative static nature of classical trade theory did not fully take into account. Therefore, he suggested that particular attention ought to be directed to unveil the connections between foreign investments, short-term capital movements, commodity trade and income growth. Reliance on Ricardo's model had rendered these connections extremely weak even though they were the "more significant part of the explanation of the present status of nations, as to incomes, prices, well being, than is the cross-section value analysis of the classical economists, with its assumption of given quantities of productive factors, already existent and employed" (Williams 1929). As an alternative, Williams suggested that international trade and capital movements should be studied "from the point of view of history" and primarily "from the point of view of their effect on the development of nations" (Williams 1928 also quoted by Dorfman 1959, V, 584-585).

From a methodological point of view, Williams also observed that international trade and monetary issues raised the most intriguing questions about the optimal relation between theory and policy (Williams 1929). If international economists had not been able to provide satisfactory responses to the economic consequences of the War and to the World depression, again much of the blame fell on abstract theorizing. Post-war events had not changed this attitude in any significant way: "one of the greatest paradoxes of recent times is that, while since 1914 the world has been in a state of profound and virtually continuous disturbance, formal international trade theory has continued to emphasize equilibrating tendencies" (Williams 1952a). On these grounds, most modern refinements of the Ricardian model were also based on the mistaken tendency "to run away from the actual problems by putting them under an expansible umbrella labelled 'short run'" (Williams 1952a).

### *2.2. Trade, growth and economic geography*.

According to Williams, factors endowments, different cost ratios as well the distortions induced by protectionist commercial policies provided only a partial explanation of the patterns of trade.

Williams started from the premise that the world was composed of very heterogeneous countries whose economic systems were characterized by markedly different stages of development. Countries of unequal size and divergent economic structures could be grouped in centre or "key" countries and peripheral countries. His approach to international trade theory and policy can be fairly summarized by the following quotation: "This is not a world with many countries mutually held in balance through compensatory internal adjustments … [but] a world with

[29] It maybe noted that while Williams observed that Leslie's major weakness was that he did not develop a rival system, he also blamed Keynes' *General Theory* for sharing Ricardo's bias of universal application of a body of principles to all times and countries.

one or two predominant key countries and with many peripheral countries which are all subject to profound changes also in their attitudes towards internal adjustment … at least until some decisive steps are made toward common sovereignty" (Williams 1951, 40-41).

In many of his writings Williams interpreted "the development of international trade as a process of expansion from a centre" (Williams 1953b, 10) which profoundly affected the economic performance of its periphery. Thus, "key countries" played a paramount role in the determination of international cycles and trends. Recent history, in fact, taught that periods of growth (as well as depressions) were generally originated in the core country while countries outside the centre owed their development, and often their very existence to the movement of factors as well as of capital goods from the centre. Williams also argued that the establishment of a stable network of peripheral countries was often indispensable for the survival of the centre, since it provided cheap labour and a steady demand for exports in the technologically most advanced sectors.

This stadial interpretation of economic development was refined with two closely connected considerations: first, the international monetary system – particularly whenever it was based on a common standard – was a powerful mechanism of propagation of shocks from key countries to their periphery; second, any theory of international trade which did not approach the subject matter in this way (cumulative changes and interactions between core and periphery) had very serious limitations as a guide to policy. Here again, Williams strongly suggested that any international economist should feel the inadequacies of static equilibrium analysis. Economists were facing just another "great paradox" of modern economic theory: "though international trade has been peculiarly characterized by growth and change, economists have continued to discuss it theoretically in static terms" (Williams 1953b, 9).

Williams also drew attention to the fact that exploitation of comparative advantages could be limited by market imperfections and failures which classical economists did not fully take into account or – again – simply assumed away from their premises. In particular, peripheral countries suffered from "inferior organization of capital and labour …, inferior domestic banking, inferior internal means of communication, inferior perception of economic opportunity" (Williams 1929, 31). More than their relative natural endowment of productive factors, such a varying degree of domestic backwardness in capital markets and the quality of information were additional determinants of the international hierarchy among countries and of the way the patterns of world trade followed the patterns of the world key direct investors, rather than the other way around. It was not by chance – Williams noted with great perceptiveness – that the performance of developing countries depended greatly on their capacity to build a cosmopolitan centre within their region which had a strategic importance for the intermediation of foreign finance, and where the presence of large-scale foreign enterprises mainly in the extractive and transport industries was particularly high (Williams 1929). Thus, capital transactions had a great impact in the performance of the domestic economy and for the determination of the structure of commodity trade.

Finally, relative positions between core and peripheries were not intrinsically static: on the contrary recent events showed that there was much room for processes of cumulative change. In his writings it is often observed that "the greatest single change which has occurred since 1914 has been in the comparative international position of the United States and England" (Williams 1932a, 272). They basically depended on the real long-run factors which affected levels of productivity and, by the political processes, which historically influenced stages of integration or disintegration of a regional or multilateral nature. Again, in order to fully understand the nature of these changes specific attention had to be devoted to the effects of the relative movement of productive factors – primarily capital.

*2.3. Mobility of factors.*

Williams thought that the most disturbing element of the Ricardian model was to be found in the international mobility of capital which the classical economists had generally assumed away for reasons of formal accuracy or for the prevailing "home bias" sentiments.[30] Under Taussig's guidance, Williams developed critical arguments against classical monetary theory, whose discussion of factors mobility was merely confined to problems connected with the balancing of international payments (Williams 1920b; 1929). On the contrary, capital movements and the international environment had pride of place in Williams' explanation of economic growth and domestic stability. In his view, the real functioning of the pre-1914 gold standard relied to a significant extent on the stabilizing function of short-term capital movements. What was even more relevant was that the factors immobility assumption had to be rejected in order to understand not only recurrent episodes of panic and crisis in financial markets but also business cycles, market failures and the efficacy of economic policy.

Williams shared the heterodox view that productive factors had traditionally moved more freely between – rather than within – nations.[31] Countries at different stages of economic development had experimented with episodes of massive migration and capital movements which had important effects on their long-run economic performance. In his empirical studies, he also showed the existence of important interactions between the capital account and the current account; the former generally exerting the more powerful influence upon the latter by means of exchange rate and interest rates variations. On the whole, capital movements were an endogenous factor in the adjustment mechanism, a crucial element in exchange rate depreciation, a key determinant of the stability of macroeconomic aggregates. Their overall significance was greater than the one played by changes in the terms of trade and in comparative factors productivity[32].

Capital and labour movements were also the most important single factor that favoured a shift in relative growth rates. Neglect of "core-periphery" implications served to explain why most recent contributions of neoclassical trade theory failed to pass the test of reality. Massive migration of capital and labour did not bring about an intrinsic tendency towards income or price equalization on a world scale (Williams 1929, 30). In his writings, Williams discussed at some length the circumstance that foreign direct investments could stimulate a more rapid rate of advance of productivity in the lending country than in the borrowing country and thus create further disparities in the patterns of growth. The recent surge of US foreign direct investments in the 1920s, he wrote, had significantly contributed to the expansion of the US domestic economy, setting in motion a virtuous circle: increasing returns, higher profit margins, and the establishment of a more efficient network of productive capacity which, in its turn, was the reason for new investments and a further cumulative rise of productivity.[33] Foreign investments by American enterprises were also interpreted as a sort of indirect insurance against domestic market failures. Among them, Williams considered the frequent incidence of phenomena of adverse selection which had affected the US credit market in the 1920s.

[30] On the basis of his early writings on the inductive verification of the balance of payments adjustment process, June Flanders (1989) concluded that Williams could be labelled as a late classical economist because he focused on specific cases of disturbances to the classical mechanism and introduced some dynamic element in the classical picture. On the classical economists and capital movements, see Asso (2002).

[31] Williams 1929, pp. 24ff. Among others, Williams quoted Bagehot, Cliff Leslie as anticipators of his views.

[32] Williams analysis of the effects of an exogenous real shock on trade flows prefigured the income or absorption approach to the balance of payments, in contrast to the prevailing acceptance of the price elasticity approach (Williams 1920b).

[33] See Williams 1951. Britain's capacity to exploit this virtuous circle, helped to understand why, for a long time, "[it] has been able to concentrate capital and labour on a small amount of land" (Williams 1929, 34).

*2.4. Criticism of equilibrium analysis.*

In his early studies on Argentina's balance of payments, Williams criticized the comparatively static approach which generally pervaded the theory of international trade. Both classical and modern models, in fact, were exclusively designed in terms of a partial equilibrium framework, placing different emphasis on the equilibrating forces at work. Rather ambitiously, Williams' approach tried to establish connections between trade flows, foreign investments, output, employment and the balance of payments. Again, his arguments rested on empirical verification which showed the non-existence of alternative stages of equilibrium. In fact, international trade and finance were influenced by a series of overlapping changes – "working some time in the same direction, some times at cross-purposes" [Williams 1920a] – which rendered equilibrium analysis rather meaningless and artificial. In international economics no analysis of the forces making for economic equilibrium was useful to illuminate this field and changes were not sufficiently systematic to lend themselves to a sort of equilibrium theory. Particularly if countries adopted inconvertible monetary standards, "this reasoning from artificially simplified stages of equilibrium through periods of transition to new stages of equilibrium" had little interpretative value. For Williams it remained "a characteristic product of the Ricardian mode of thought" [Williams 1920a].

Therefore, in the interwar years, the distinction between short-term factors – whose operation created instability and maladjustments – and long-run forces – which inevitably worked on behalf of stable equilibrium – was deemed to be utterly misleading. On the contrary, transitions from one core to another – like the one that occurred between Great Britain and the United States after WWI – produced a shift away from equilibrium and smooth adjustments, also because of structural changes. For example, the emergence of the US economy as the core trading country had managed to produce a number of shocks which negatively affected stability and growth. Among them Williams emphasized its great size and the strength of its home market; its diversified resources and the large exports surplus; its comparative self sufficiency; and its more rapid pace of innovation and productivity growth (Williams 1952b, 176). Using similar arguments to Albert Hirschman's analysis of the "influence effects" applied to the Nazi economy (Hirschman 1945), Williams argued that all these features generated a greater dependence of the rest of the World on the American economy, rather than conversely. They represented objective circumstances which explained deep-seated, long-term imbalances in international payments and led him to suggest the diagnosis of chronic "dollar shortages".

In retrospect, one could say that Williams' contributions to international trade theory and his criticism of standard economic theory lacked formal accuracy and suffered from vagueness[34]. Nevertheless, they contained many original seeds which profoundly influenced subsequent developments of trade theory and international political economy. For Williams, what mattered was that they were also strictly connected to evaluate the orthodox interpretation of the real functioning of monetary systems and adjustment mechanisms – beginning with the international gold standard. This was another crucial step toward the development of new principles for the reform of the international monetary system in the interwar years and must be considered in detail.

## 3. Williams' criticism of the international gold standard and monetary policy

On several occasions, Williams disputed the conventional interpretation of the gold standard as a monetary system which provided an automatic mechanism for balance of payments adjustment and a neutral set of rules for economic policy authorities. In his view there was nothing intrinsically

[34] David Laidler recalls both Lauchlin Currie and Paul Samuelson commenting in letters to him on Williams' work in ways that suggested that their high personal regard for him was tempered by a certain impatience for his lack of analytic precision.

automatic in the functioning of the gold standard. Williams' criticism of the gold standard model moved from the specific nature of its assumptions and his interpretation echoed many arguments which we have already found in his writings on international trade theory (Williams 1932a and b).

In what follows we have chosen to discuss three points which are quite recurrent in his writings. They concern the role of capital movements and their effects on economic performance and the efficacy of monetary policy.

*3.1. Capital movements and the adjustment process.*

According to Williams, the gold standard was a monetary system which operated on the basis of a core-periphery structure: its stability depended on the existence of a common centre "with which the other countries were connected through trade and finance" (Williams 1944a). In fact, the smooth working of the pre-war international monetary system in its heyday until 1914, depended on the strategic and hegemonic role played by key countries – particularly Britain – which helped to enforce policy discipline and international co-ordination. To our knowledge, Williams was among the first economists to suggest that, until 1914, the system was really based on a sterling standard rather than on gold and that the reasons why the system worked so well were to be found in the specific roles which the countries – both at the core and at the periphery – agreed to behave. Williams noted that exchange rate stability depended on sterling acting as the "key currency" of the system. "Key" in the sense that sterling was the vehicle of all international transactions on both the current and the capital account while a growing demand for sterling-denominated assets financed Britain's structural external deficits. The crisis of the international gold standard coincided with the relative decline of the British economy. In this respect, Williams thought that the War had simply hastened a process of change which was already well under way (Williams 1953b).

This picture sharply contrasted with traditional gold standard theory which was based on the principle of interaction between homogeneous countries of approximately equal economic size and structure (Williams 1944a).

Williams recognized that the gold standard had the great merit to give monetary policy a clear and definite objective. However, he often criticized as false and abstract the dilemma – which Keynes had emphasised in 1923 – between internal and external stability. As he saw them, modern economic systems were characterized by a growing interdependence between internal and external components of aggregate demand. For peripheral countries, economic growth greatly depended on the performance of leading economies. If the latter were unsuccessful, the former could not be maintained, regardless of policy attitudes or nominal flexibility in price or wage setting.

Williams agreed with many interpreters that the most serious defects of the gold standard as a mechanism of adjustment depended on the growing rigidity of internal prices and costs, which ultimately explained the phenomenon of gold mal-distribution. In the most advanced countries prices remained insensitive to gold movements, particularly downwards. The presence of rigidities also reduced the opportunity to construct an economic or monetary policy around the focus of exchange rate stability: "in the view of many economists, we must find ways of lessening rigidities or find ourselves forced to give up the free price-quantity system of economic adjustment altogether" (Williams 1937). Moreover, gold standard rules required pro-cyclical policies which most governments were quite unwilling to follow, particularly those who were forced to accept contraction and unemployment whenever gold flowed out.

However, apart from the reduced flexibility of most contemporary economic systems, the second and most serious source of troubles "for any international monetary system" was to be found in the mobility of productive factors – most specifically, capital. His studies on Argentina had shown that capital inflows had a great impact on the gold premium, which established unfavourable connections with exchange rate variations and the burden of the public debt service. The stability and the adjustment of the Argentine economy depended not only on domestic conditions or price flexibility but were mainly connected to the vagaries of the international cycle and to the abrupt decline of inward capital flows.[35]

Starting from these premises, Williams wrote many essays to discuss the perverse role of capital movements to the stability of any international monetary system and as a major cause of economic recessions and their international propagation.[36] In this context, Williams denounced contemporary economists for not having given proper consideration to the causes and ultimate effects of short-term capital movements. They had passively accepted the classical doctrine which assumed that capital movements held a balancing function in the adjustment process of external shocks. Most of the times, however, their behaviour followed different rules of the game than were generally assumed by classical economic theory.

Again, factual knowledge and empirical research helped. Economists could find out that not only was capital an extremely mobile and fluctuating item of the balance of payments – indeed its most mobile and fluctuating one – but it basically flowed in the opposite direction from the one assumed by Hume's mechanism. In fact, inductive verifications had shown that there was no offsetting tendency between domestic inflation and the export of capital: rising prices were often accompanied by further capital inflows, since net foreign investments were attracted by surging economic activity and favourable profit expectations. On the contrary, in times of sluggish business confidence and economic depression, many economies generally experienced a flight from their currencies and net capital outflows which worsened the external account (Williams 1932a, 272ff).

Williams was also struck by how quickly and easily the current account adjusted to – and was dominated by – the capital account, rather than the other way round. Even if the terms of trade changed in the direction predicted by the classical theory, Williams thought that these changes were too small to have been responsible for the recorded shifts in the balance of trade.[37] Moreover, for some countries free access to the international capital market was a major cause of intergenerational problems and structural imbalances: in fact, it served to postpone fundamental readjustment of their economic system by offsetting long-term capital exports with short-term capital imports.

For all these reasons, it followed that the gold standard was not a reliable corrective mechanism of capital movements. For many countries, its traditional rules of the game did not operate while the quantity theory of money had only a rather limited validity. Other effects stimulated by aggregate expenditure and the transfer of purchasing power held primary responsibility of adjustment processes. Ever since the early 1930s he shared Keynes' belief that the addition of a borrowing authority to supplement the use of a central bank's reserves represented a major step forward for the implementation of international stabilization plans (Williams 1931).

*3.2. Capital movements and the propagation of cyclical instability*

Williams also discussed at length the possibility that international capital movements could become the vehicle for worldwide booms and depressions. The network of financial connections between core and peripheral countries served to explain why the gold standard was a means for spreading "depressions, and sometimes booms, from one country to another" (Williams 1944a, 171). In times of crisis, Williams argued that the gold standard could become a mechanism for growing disequilibria and the production of disturbances which extended to neighbouring countries.

[35] See Fishlow 1989 for an application of Williams' ideas on this point.
[36] See, among others, Williams 1944a.
[37] Williams' contributions on this point are emphasised by Mundell (1997).

Adherence to an exchange rate commitment and to schemes of international coordination inhibited monetary authorities from undertaking desirable stabilization policies.

Consistent with his functional interpretation of the gold standard, Williams again found the main seeds of the contagion in the growing interdependence between the external and the internal economy: a sudden cessation of capital movements and the burden of fixed interest charges produced depressive effects in the capital-importing countries which "then may spread back through the channels of trade to the capital-exporting, interest-receiving countries" (Williams 1932a). Whenever the drain of foreign capitals had reached abnormal levels, capital movements provoked the too familiar sentiments which had fuelled the world depression and unemployment far beyond their cyclical swings: uncertainty, distrust and speculative excesses tended to produce cumulative one-way movements. While monetary policy had limited powers to offset them, it was no sheer coincidence – so Williams wrote in 1932 – that most episodes of booms and depressions had international capital movements as one of their most prominent features (Williams 1932a).

From what we have seen, it is not surprising that Williams remained a life-long advocate of exchange controls. In his view, abnormal capital movements from core to peripheral countries were the international counterpart of domestic runs on the banks and other forms of "internal money panics" which had played such a large part in economic history. Being "the most volatile item of the balance of payments" (Williams 1937, p. 29), capital movements managed to dominate and even nullify alternative corrective policies which were designed to support macroeconomic stabilization. What was worse, it sometimes occurred that they produced real policy dilemmas and reduced the efficacy of monetary policy. One possible explanation was that, in the presence of unfettered capital movements, expectations tended to become "self-fulfilling". Many historical episodes provided interesting evidence in this respect: raising the rate of discount to protect the internal economy against a capital flight had often intensified deflationary pressures and had been taken as a symbol of fear that further flight would undermine the stability of the exchange rate, "which has led to further flight". Other situations may occur whereby "a rise in the rate designed to curb internal expansion may attract short-time funds from abroad" (Williams 1937 p. 29). Finally, the destabilizing nature of capital movements also depended on the weak connections between the financial and the real sectors of the economy. Empirical research supported this conclusion, showing how frequent it was that the main purpose of international capital movements was not to create new productive capacity but to meet extraordinary expenses of unproductive nature (Williams 1932a).

In terms of policy, throughout the 1930s, Williams advocated world economic co-operation as the best method to cope with contractions of output and employment. With the rise of rival financial centres after the end of WWI, Williams believed that stability of international agreements and policy co-ordination depended on the negotiation of credible commitments. Discussing this issue with Keynes, Williams maintained that the gold standard was just "a short-hand phrase for exchange stability" which was achieved by monetary discipline imposed by a country's sense of its obligations to other countries and by informal central banks cooperation.[38] In his view, policy credibility was an important requisite to increase policy efficiency and counteract downward cyclical variations of the relevant macroeconomic magnitudes. He thought that the best way for monetary authorities to discourage destabilizing speculation and control the volume of capital movements was their "demonstration of purpose and capacity" to maintain a system of fixed exchange rates by mutual exchange of information, by the practice of currency swaps, and by a

[38] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.

declaration of unlimited support of each other's currencies in case of need.[39] Since 1935 Williams pressed the Roosevelt administration for a firm agreement on exchange rate stability to be achieved by a daily gold settlement at fixed nominal rates of the three key international currencies. With respect to the other requirements of international co-operation, he remained well aware that the framework of the Tripartite agreement were rather disappointing and weak.[40]

### *3.3. Monetary policy and the art of central banking*

In the 1930s Williams gave important contributions to the analysis of monetary policy and to the interpretation of the great depression. While at Harvard and at the New York Fed, he tried to understand the mechanisms of transmission of monetary forces and the way monetary authorities could increase their capacity to stabilize the economy, both domestic and international. His early criticism of the quantity theory of money did not prevent him from pointing out the danger that, in the 1930s, monetary theorists had swung too drastically from overemphasis to extreme underemphasis of the role money supply. He believed that monetary authorities could regain control over the economic system by strengthening their capacity to control the credit market and increase their level of independence from the Treasury.

Williams' essays on monetary policy together with his reports on banking reform contained critical remarks of Federal Reserve policy before and during the Depression. Williams espoused the thesis – which had been elaborated by his Ph.D student, Laughlin Currie, by Jacob Viner and others – that the Federal Reserve System was responsible for precipitating the American economy in the Great Depression. He himself saw serious errors by the Fed in the banking crisis which in the first half of the 1930s brought the American credit system very close to collapse. Under different perspectives the Federal Reserve System was faulty. It basically lacked effective powers of banking supervision and had no capacity to safeguard the solvency of banks (Williams 1935).

Williams put forward interesting arguments to substantiate the widespread scepticism towards monetary policy and its capacity to maintain macroeconomic stability. In the worst days of the economic depression, he declared little faith in the effectiveness of interest rate policy to stabilize business conditions and to reflate the economy. His perceptions were based on a negative correlation between a cheap monetary policy, the safeguarding of the profit margins of the banking system and the restoration of business confidence. Anti depression policies did not require a countercyclical expansion of the monetary base because interest rate reductions had perverse effects on the solidity of bank assets and provoked a deterioration of the balance sheet of commercial banks.

Scepticism about the effects of monetary policy again depended on the weak connections between the banking sector and the real sector. Interest rate policy exerted little influence on investment decisions while practices of borrowers' discrimination and credit rationing were more important factors influencing the money market (Williams 1931, 248ff). The main channel of transmission of monetary policy depended on the impact of interest rate variations on the availability of bank credit. From his reading of Keynes' monetary essays Williams added two further considerations: first he believed that small changes in interest rates did not have any great effect on economic activity and prices, while large changes were likely to have negative effects on business expectations. Secondly, he thought that the fundamental cause of the world economic depression was the persistent gap between long-term and short-term interest rates. He believed that

[39] See Bloomfield 1950 where interesting similarities are made between Williams, Paul Einzig and Ralph Hawtrey. Arthur Bloomfield worked with Williams at the New York Fed.

[40] J. H. Williams, "Gold Policy. Memo to Secretary Morgenthau", 14 January 1935, The Federal Reserve Bank of New York, Williams papers.

Keynes' *Treatise* had not succeeded in explaining causes and remedies of this discrepancy. In his 1931 long review-article of Keynes' new book, Williams argued that Keynes' monetary theory was built on the wrong assumption that the long-term financial market was extremely sensitive to changes in the bank rate. By contrast, reality showed that a wide gap fragmented the capital market while there were non-monetary difficulties which basically affected aggregate demand and which "[we]re not sufficiently amenable to monetary action" (Williams 1931, 252ff). In this context, the distinction put forward by Keynes and other business cycle theorists between the market rate and the natural rate of interest did not represent an important theoretical advance: it was rather a rhetorical gimmick, since "the natural rate is not visible; it is an abstraction" [Williams 1931, 248].

According to Williams, ever since its foundation, the Federal Reserve System had been dominated by advocates of the "real bills doctrine" who denied any relation between their acts and inflation. The System's adherence to the real bills doctrine – combined with a belief that a "natural" purging of speculative excesses was necessary to set the stage for price stabilization and recovery – led to the failure of monetary policy. Whatever the intellectual origin of the Federal Reserve Act, Williams believed that the real bills doctrine was of little use when trying to understand post-war mechanisms and effects of monetary policy. In particular, after the 1919 economic recession, many business concerns "shied away from banking loans, with the result that commercial paper, already diminishing in relative importance before the war was reduced to only 12% of bank assets in 1929 and 8% today". Therefore, the notion of "eligible paper" should be replaced by the notion of "sound assets" (Williams 1936).

These changes in the character of central and commercial banking – Williams observed – coincided with the emergence of a new phenomenon in the credit market. Banks developed a strong preference for the selection of comparatively low risk operations, such as the purchase of government securities at the expense of the investment needs of private enterprises (Williams 1945). Williams thought that the growth of public debt had produced revolutionary changes in both central and commercial banking, and he watched with preoccupation the growing tendency of banks to hold secondary reserves of government securities. He also observed that high bank earnings coincided with periods of low but stable interest rates which determined an increasing volume of safe transactions in the market for public bonds and a more efficient management of the public debt structure. On the other hand, commercial banks had become extremely vulnerable to interest rate changes because most of their assets were concentrated in government bonds. As a consequence Williams feared that all economic subjects ("the public and the Treasury, as well as the banks"), were developing strong vested interests in the stability of interest rates which, in fact, had become the primary objective of monetary policy (Williams 1945, 219).

On the grounds of this diagnosis, in order to increase the efficiency of monetary policy, Williams frequently wrote in support of the creation of a modern central bank machinery for credit control and the maintenance of economic stability. In his writings and in his official activities, Williams favoured legislation which extended the scope of Reserve Banks' lending operations and reorganized the Federal reserve system with a view to increase its powers of direct credit controls and supervision. Central monetary authority needed to be transformed from an agency which provided an elastic credit supply to meet the needs of investment and trade into an agency for credit control. As he wrote in a report on central banking, the philosophy which had inspired the 1913 Federal Reserve Act needed to be reconsidered: "there has arisen since the War a great diversity of views with respect to the status and functions of central banking institutions; their relations to government and to the commercial banks; their responsibility for currency and credit control".[41]

[41] J.H. Williams, "A program for banking reform", (undated but 1935), Archives of The Federal Reserve Bank of New York, Williams papers.

To increase the flexibility of the credit market and enhance the control capacities of the Federal Reserve System, Williams suggested a drastic revision of the character of central banking. He dismissed as unrealistic all proposals which found inspiration in the recent wave of European banking reforms and policy innovations. Major conversion operations of the public debt would have shaken confidence in the Treasury solvency, while he opposed the transformation of commercial banking into State-owned enterprises. His writings contain several suggestions regarding possible reforms in the art of central banking. First, he denounced the fact that the Federal monetary authorities lacked the means for efficient banking supervision. They had no powers to prevent banking excesses to ensure the solvency of banks, particularly in non-commercial assets. Credit controls – Williams observed – were no longer a question of measuring the adequacy of reserve requirements but needed to be exerted over the quality and soundness of bank assets: "inability of the banks to borrow from the reserve banks upon sound assets … was not due … to defects in the machinery of organization and utilization of reserves, but to a general impairment in the value of banks assets so great as to reveal very strikingly the underlying weakness in our whole system of banking organization and supervision". Williams put the blame for the higher failure rate of American banks compared to Canadian or British banks to bad loans and limited diversification.[42] Thus, the modernization of the American banking system required the development of more efficient methods of "relationship banking" between central and commercial banks. The inadequacy of contacts was viewed by Williams as one possible explanation of the reasons why the 1929 stock market crash had turned into a general collapse of the credit system. In particular, at the worst stage of the depression, many banks suffered from the absence of a lender of last resort and found themselves forced to dispose of sound assets by sale, thus contributing heavily to the general deflation and undermining their own solvency (Williams 1936).

Secondly, Williams proposed that Central Banks should be given a considerable amount of discretion and independence when dealing with the system of commercial banks on the one hand and the government on the other: "as regards commercial banks, the Central bank must have power to control them unaffected by profit-seeking considerations". Regarding the difficult relationship with the Treasury, Williams believed that a more definite delegation of discretionary powers was "desirable and necessary in order to safeguard against the possibility of hastily considered or politically determined actions". Central bank credibility for credit and currency control would be strengthened and rendered more efficient if independence in monetary policy decisions was among its prerogatives (Williams 1935). Proposals in this direction ranged from a general prohibition from buying government securities other than in the open market to an increase of salaries of Board members in order to enhance their status and autonomy. He also favoured increased centralization of the powers of credit controls without impairing the regional character of the reserve system. In his view, the concept of the Federal Reserve Board as a board of review of policy decisions of the reserve banks without powers to initiate changes in policy had created confusion, an excessive diffusion of responsibility, cumbersomeness and delay. He saw in the creation of an Open market committee a real piece of central bank machinery and the right solution to clarify the policy responsibilities of the reserve system in matters of credit policies.[43]

## 4. Williams' plan for international monetary reform: the key currency approach

[42] The reason for this comparison was due to the fact that "England with a central banks, and Canada without a central bank, entirely escaped bank failures".

[43] Williams strongly supported the use of open market operations and in 1932 played a key role in drafting the cable to president Hoover urging him to support vigorous open market operations combined with public works (Williams 1932b). In his private correspondence with the authors, David Laidler notes that in the early 1930s some of the ideas of the so-called Chicago tradition had flourished among a small group of Harvard economists – Williams included. See also in this connection Laidler 1993 and Laidler and Saindilands 2002.

*4.1. Criticism of official plans*

Since the beginning of the negotiations for a new monetary order, Williams was actively involved in the discussions which eventually led to the approval of the Bretton Woods agreements. Williams activities ranged around three main aspects which will be the object of our analysis in this and the following Sections. They regarded:

1. A detailed criticism of the two official plans
2. The elaboration and the defence of an alternative plan based on the stabilization of the world key currencies
3. The participation in the negotiations in order to introduce amendments in the official plans in line with the key currency approach

As we shall see below, Williams's criticism was equally addressed to White and Keynes. However, at least at the beginning of the negotiations, he thought that the US proposal deserved greater support for reasons of political opportunity: among them he mentioned the fact that a Clearing Union would put the Fed in a difficult position because of its inflationary bent. As he put it in a letter to the Board of Governors of July 1943, "the provision of foreign exchange resources to other countries on the scale suggested by Keynes would be an extremely hazardous undertaking from the standpoint of this country".[44] On these grounds, White's scheme was to be preferred also because the US were granted more veto powers.[45]

As a monetary reformer, Williams received widespread recognition within American economics. He believed that the key currency approach did not offer an outright substitute for a full-scale international agreement on exchange rate stabilization nor a new mechanism for balance of payments adjustment. As he wrote to the governor of the Bank of Canada, Louis Rasminsky, he had "no desire to be the spearhead of any countermovement".[46] However, he thought that the introduction of the White plan needed to be preceded by the stabilization of key currencies which would make the establishment of a new international monetary order more gradual and sustainable. In this manner, he felt sure that the risks of failure of the new ambitious institutions would be greatly minimized.

William found several major shortcomings in the two official plans which were respectively related to their theoretical vision, technical provisions and institutional setting. He also believed that some improvements were made during the negotiations.

First of all, White's and Keynes' proposals to establish a multilateral system of fixed but adjustable exchange rates was too abstract and ambitious: the two plans were "like a mirage", being full of "high sounding words and sentiments that do not get us anywhere".[47] In fact, the lessons of the 1920s stabilization plans advised against the immediate determination of new exchange rate parities. Williams thought that the current exchange rate structure was meaningless, and that member countries needed time to find a new, sustainable relationship between their respective

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[44] J. H. Williams, Letter to the Board of Governors, 15 July 1943, Archives of The Federal Reserve Bank of New York, Williams papers. Three months later, in the midst of the Washington negotiations, he reaffirmed that the Clearing Union plan contained the "dangerous promise that countries by right of membership have a credit line for a substantial amount of US$". J. H. Williams, "International currency stabilization. Statement presented to the Board", 7 October 1943, Archives of The Federal Reserve Bank of New York, Williams papers.

[45] Williams to the Board of Governors, 15 July 1943, Archives of The Federal Reserve Bank of New York, Williams papers.

[46] Williams to Rasminsky, 12 August 1943, Archives of The Federal Reserve Bank of New York, Williams papers.

[47] These comments were included in an unpublished version of Williams first article on these matters (Williams 1943). This version had only an internal circulation and can be seen in the Archives of The Federal Reserve Bank of New York, Williams papers.

currencies. For a long time after the end of the War the initial par value of all currencies could not be determined with any degree of scientific accuracy. In this respect, the Fund's resources were utterly inadequate for the task of re-establishing an international payments system and they would soon be burnt in defence of a fixed exchange rates regime (Williams 1943 and 1944b).

Lessons of the 1920s had not been learnt too well also from another standpoint. Williams recalled that, under the weak supervision of the League of Nations, a wave of doubtful loans were launched in attempts to support uneconomic levels of fixed exchange rates. He also added that monetary reforms in the interwar years had disastrous effects for Wall Street and the network of peripheral countries, because "we lent too freely and then stopped altogether".

As he wrote in a statement prepared for the Federal Reserve Board, Williams feared that the process of establishing new exchange parities would provoke a massive wave of destabilizing speculations and disorders in financial markets. Should that occur, the Fund risked being discredited for a long time: its fate would be doomed even before it had officially started its lending operations. A more viable solution was to reach a bilateral agreement on the sterling-dollar exchange rate. Therefore, the soundest alternative solution was to follow the method of trial and error, beginning with the key currencies.

Secondly, White's and Keynes' projects were too premature. Williams' most telling criticism of both plans was that they completely failed to distinguish between the problems of the transition and the problems of peace, between Western Europe's immediate financial requirements and the shock-absorbing activities of the new Stabilization fund (Williams 1943, 151ff). In a vast number of essays and reports he tried to prove the point that both plans were characterized by the lack of attention to transitional problems. The Fund and the World Bank could not cope with the problems of transition. They had limited resources while uncertainty about what European future and economic performance was great. Williams anticipated that it would take at least five years before Great Britain could be ready for multilateral trade and the elimination of current account restrictions because of the large volume of inconvertible sterling balances accumulated in foreign countries.[48] He also feared that the setting up of an International Monetary Fund could obscure the need to arrange relief and reconstruction and to be a scapegoat for US responsibilities as the "key" country.

At this stage, Williams was among the first economists who warned against the danger of a possible scarcity of key currencies – namely a dollar shortage – if the IMF was to be employed in the transition or to finance the settlement of sterling blocked balances. Williams denounced the fact that increased post-war demand for dollars could not be satisfied by the Fund's resources while the new institution would soon be converted into a stagnant reservoir of unwanted currencies: "Very soon after the beginning of operations the Fund will be long of the weaker currencies and short of the key currencies in which international transactions are actually carried out".[49]

As the negotiations proceeded, Williams' dilemma began to receive widespread consideration and new technical provisions against the dangers of a dollar shortage were approved by the delegations of experts. Williams believed that some of them represented important improvements in the monetary mechanics of the Fund. Particularly those which introduced the scarce currency clause, imposed progressive interest rate charges and established forms of

[48] Meltzer (2003) has observed that "his arguments lost some of the persuasive power when the United States agreed to the British loan but he was right about the difficulties Britain would have in the post-war world".
[49] J. H. Williams, "International Currency Stabilization", 21 Dec. 1944. Archives of The Federal Reserve Bank of New York, Williams papers. See also J.H. Williams, "Notes on a Meeting with Treasury Experts", 10 September 1943, Archives of The Federal Reserve Bank of New York, Williams papers.

repurchase agreements, went in the right direction. In his opinion, however, these remedies still remained a "second best" solution, if compared to the approval of a transitory system based on the key currency plan. Williams dismissed as politically unfeasible the option that – should the dollar shortage occur – the Fund imposed "buy backs" of weak currencies with dollar reserves that member countries possessed outside the Fund. Moreover, he was convinced that the Fund machinery did not technically allow for a dollar appreciation because this decision could never be taken unilaterally without a previous Washington consensus.[50] As a consequence of the dollar shortage, Williams correctly anticipated that the Fund might soon need to be refinanced by some borrowing arrangement with the leading financial powers which would contribute to the undermining of its authority and political independence.[51]

Finally, the two official plans had too many theoretical and technical shortcomings. For the author of the key currency plan, three of them were particularly noteworthy.

First, both plans bore too close a family relationship with the textbook type description of the gold standard and their success depended on the circumstance that surplus and deficit economies behaved in a flexible and symmetric way. As far as the adjustment mechanisms of external disequilibria was concerned, Williams observed that the rationale of both plans was weak: not only did they neglect the role and weight of domestic policies in ensuring prospects for stability and growth but what was worse they almost completely failed "to mention the need for internal adjustment" (Williams 1944a, 171). Stabilization, in fact, was just a misnomer since "all the stabilization measures are left out".[52] Drawing from his early academic writings, Williams wrote that international stability depended mainly on the internal stability and growth of the leading economies, while both plans followed a global approach and were based on a principle of equality in the world's currencies which simply did not exist[53]. Key countries – he urged – must express a strong and explicit commitment to economic stabilization: "The best prospect for general stability is to be found in internal stability in the leading countries" (Williams 1937, 49) while "economic conditions of young countries primarily reflect the conditions existing in the great world markets, for which they are only secondarily responsible" (Williams 1943, 152). Stability and mutual co-operation at the centre produced positive externalities to the benefit of the peripheral countries: "There is no dilemma between internal and external monetary stability as has been frequently emphasised in abstract analysis".

Since their first draft, Keynes' and White's proposals for a new international institution did not consider the kind of corrective measures that countries were obliged to impose in order to ensure or regain domestic economic stability as a prerequisite of international stability. Undoubtedly, the reasons for this omission were "in part political", because core countries were unwilling to subscribe hard commitments or surrender national sovereignty (Williams 1944a). However, having been a long-time reader of Keynes, Williams was surprised by "the lightness of touch" he had found in the Clearing Union plan on domestic economic reforms and stabilization policies (Williams 1943, 151). He found one plausible answer in Keynes' confidence that the new world organization would soon become a forum which provided a form of efficient world

[50] On these issues, see J. H. Williams, "Memorandum on a Meeting of the Board of Directors", 17 August, 1944, The Federal Reserve Bank of New York, Williams papers and Williams 1944b.
[51] Meltzer (2003, 619) also thought that "although Sproul and Williams did not express their distaste for an international organization, they must have seen the plan as a further weakening of New York's influence on international economic policy".
[52] J. H. Williams, "Statement at the meeting of the Board", June 6, 1944, Archives of The Federal Reserve Bank of New York, Williams papers. See also Meltzer 2003, 619.
[53] This point is discussed in Williams 1943 and 1944a, and was explicitly raised in several internal memoranda: see J. H. Williams, "International Currency Stabilization", 21 December 1944, The Federal Reserve Bank of New York, Williams papers.

government. This was a rather platonic vision of the world, as Williams wrote to the Governor of the Bank of Canada, since the establishment of a system of fixed exchange rates was a long way from complete surrender of national sovereignty to a bunch of illuminated technocrats.[54]

Second, the two plans would soon find a deadlock in what is nowadays called the "impossible trilemma". In fact, Williams feared that the Fund's mechanics would feed an insoluble alternative between fixed exchange rates, free capital movements and the independent pursuit of monetary policies. In his reports to the Board of Governors, Williams recalled that, as Keynes himself had shown in *The Treatise on Money*, this trilemma could again find a solution in a world with supra-national monetary authorities which effectively exerted their coercive powers on capital movements. Such a world – Williams warned – simply did not exist. On the contrary, as it was expected that in the post-war era, most nations would follow independent economic and monetary policies, countries would not be able to defend their exchange rate parity in the presence of perfect capital mobility. In this perspective Williams also warned against the great practical difficulty of distinguishing between transactions on current account – which should remain free – and those on capital account – which White's Fund temporarily allowed to prohibit by the retention of national systems of exchange control.[55]

Third, White's and Keynes's plans provided no workable condition for the eligibility of IMF loans. In particular the agreements contained no definition of what was meant by temporary disequibrium of the external accounts. A related problem was that IMF rules did not indicate what should happen, when and if the key countries which issued the world reserve currencies should run persistent current account deficits. On this account, Williams denounced both plans on the grounds that they contained only a sketchy treatment and no precise definition of the principle of conditionality. Again, the Harvard economist anticipated that the Fund would never be influential enough to promote – and in some cases impose – the appropriate financial policies on the borrowing countries. He feared that most members of the new institution would retain an unconditional and automatic drawing right, regardless of their creditworthiness. Making use of his familiar distinction, he believed that key countries would never accept a curtailment of their economic sovereignty or submit their policy decisions to the sort of necessary scrutiny implied by conditionality.

Williams' remarks on conditionality showed great perceptiveness of what would become the real burning issue in the history of the International Monetary Fund. If the Fund became a passive transfer agent with no active discretionary authority, Williams wrote that its resources would not be preserved for a long time while its credibility would rapidly be undermined and the seeds for its rapid failure be planted. On this issue, he thought that Keynes' plan fared better, because whatever conditionality the Stabilization Fund managed to acquire, it would sooner or later be weakened by the US refusal to grant borrowing powers.

These criticisms struck the target and were the origin of a violent controversy within the Administration. Although the pace of his publications was somewhat reduced as the Conference date approached, Williams anticipated that the Bretton Woods agreements were doomed to fail. In an official statement to the Board of Governors, Williams marked it as a "rubber stamp conference".[56] On the grounds of the insurmountable difficulties to present a uniform view, he supported Governor Eccles for the fact that "he has not made up his mind, re[garding] the Board

[54] Williams to Rasminsky, 12 August 1943, The Federal Reserve Bank of New York, Williams papers. See also similar remarks in J. H. Williams, "Letter to the Board of Governors", 15 July 1943, The Federal Reserve Bank of New York, Williams papers.

[55] See various essays in Williams 1949 and particularly Williams 1944b, 115fn.

[56] J. H. Williams, "Statement at the meeting of the Board", June 6, 1944, The Federal Reserve Bank of New York, Williams papers.

position on the fund".[57] Nevertheless he thought that, after two years of negotiations, what remained of the original Keynes' plan or of all the projects related to investment and commercial policy, was of little substance: "teeth should be put in this plan while the experts have taken out everything that expressly could suggest that there are any teeth in this plan to maintain exchange stability".[58]

### *4.2. The Key Currency Plan*

In Spring 1943, at the time that discussions on the new international monetary system began to acquire momentum, Williams presented his key currency plan (Williams 1943). Quite obviously, like Keynes and White, Williams' plan drew on the experience of the interwar years. One could speculate that while the two official plans were more influenced by the 1930s debates and new deal policies to find a way out from international disintegration, Williams was more concerned with the failure of the 1920s League of Nations stabilization programmes.

When the plan came out, most contemporaries observed that its strength was more in the critical suggestions towards the official plans rather than in the technical and institutional innovations. Keynes himself contributed to form this judgement. In his personal copy of Williams' first *Foreign Affairs* article, Keynes had noted with approval: "A very intelligent and moderate criticism". Twelve months later, when the Joint Statement was about to appear in press, in a personal letter to Lord Catto, Keynes added the following comment: "this is an able article, but its criticism is much better than its constructive proposals – which are almost nil".[59]

Williams was quite upset to find out that the various official drafts which circulated across the Atlantic contained "not a word about my preferred approach of going from the big countries to the smaller ones. A world-wide approach to an International Monetary Fund is the wrong approach, based as it is on an inadequate theory of international trade organization. Bad idea to apply one system to all countries since they are at different stages of development and have different functions".[60] Nevertheless, Keynes' remarks were quite correct and, as a matter of fact, the technical clauses of Williams' plan were never spelled out in great detail, even though careful examination of his published writings, congressional hearings and written reports provide a slightly different picture. His plan contained some original insights – particularly for what was regarded as the rationale of a more limited approach to international monetary reform. In what follows we will briefly examine some of its most interesting features.

*The exchange rate system*

We have already noted that Williams's plan was based on the premises that currencies of member nations were not of equal quality and acceptability in international transactions and that in a multilateral trading system most transactions were settled with just two or three currencies (Williams 1943). By definition, key currencies were those most commonly demanded as international means of payment. On these grounds, Williams believed that one crucial condition for post-war recovery of world trade and international investment was the stability of the "key currencies" exchange rate. As he put it in a meeting at the Federal Reserve Board, "the essence of monetary stability is to stabilize the major currency and all else flows from that. If you do that it is

[57] Williams to Sproul, 7 April 1944, The Federal Reserve Bank of New York, Williams papers.
[58] J. H. Williams, "Statement at the Meeting of the Board", June 6, 1944, The Federal Reserve Bank of New York, Williams papers.
[59] Keynes to Lord Catto, 22.2.44, T/160/1287, quoted by Pressnell 1986, 154.
[60] J. H. Williams, "Statement at the meeting of the Board", June 6, 1944, The Federal Reserve Bank of New York, Williams papers.

much easier to permit of exchange controls and exchange rate variations for the younger countries. This does not really affect stability".[61]

Thus, Williams' plan favoured a two-speed approach to monetary reform by permitting different paths of adjustment to convertibility and multilateralism. The first stage was characterized by the stabilization of the key currencies – notably the bilateral dollar/sterling exchange rate – with flexible fluctuations of all other currencies. Only in a later phase, in fact, would non-key countries be allowed to join an international monetary system based on fixed exchange rates and managed by supranational institutions.

The cornerstones of Williams' exchange rate agreement between the two key currencies were also quite simple and were represented by a slightly modernized version of the 1936 Tripartite agreement: they basically consisted in an exclusive monetary agreement between England and the United States with the fixing of a new exchange rate parity; parities could not be changed without preliminary consultations while both central banks were required to purchase each other's currency in specified amounts and with specific safeguards against losses; more currencies were gradually included in the new agreement once their external value was sufficiently in line with purchasing power parity in terms of key currencies.[62]

*The institutional setting*

One fundamental implication of the plan was that, in an imperfect world, no major effort of institutional design should be undertaken, at least until more stable economic and political relations between major trading countries were satisfactorily restored. In particular, Williams advised strongly against the establishment of an International Monetary Fund before serious progress was made in the post-war transition. New economic institutions could be designed only after the foundation of a new political institution. As he wrote to Rasminsky: "A world organization for monetary stabilization ought to be a sub-head under whether there is to be some sort of a United Nations political set-up".[63] The Fund was opposed as a matter of timing, not principle. He opposed starting it at a time when there was no hope of restoring multilateral trade and convertibility.

Allan Meltzer's reconstruction adds interesting details to this point. Meltzer shows how Williams and Sproul caused a stir when, alone among Fed officials, they testified in that vein before Congress in 1945. During the negotiations and in his meetings with Keynes, Williams endorsed the project of a World Development Bank viewing it as a more appropriate vehicle for easing the severe dislocations in the immediate post-war period. He suggested that the new Bank should be assigned more limited purposes of specific reconstruction investment loans. When the establishment of an International Stabilization agency appeared inevitable, Williams forcefully suggested that it were transformed into a special department of the World Bank.

*Nature of commitments*

An interesting aspect was Williams' suggestion that credibility in commitments helped to create a more stable international monetary order. While discussing the "key currency plan", Williams acknowledged that the establishment of soft but credible commitments increased the efficacy of stabilization policies and strengthened central bank cooperation. On these issues, he agreed that the Tripartite agreement lacked effective mechanisms for enforcing coordination.

[61] J. H. Williams, "Statement at the meeting of the Board", June 6, 1944, The Federal Reserve Bank of New York, Williams papers.
[62] Adoption of Williams' plan also called for a large Us loan to meet the transitional needs of the other key country, a thorough going solution to the problem of the sterling balances.
[63] Williams to Rasminsky, 12.8.1943, The Federal Reserve Bank of New York, Williams papers.

Conversely, the White plan was based on "too many rules and regulations, too many pains and penalties, and too many functions for the new world governing body".[64] If his anticipations were correct, the universal commitment to a fixed exchange rate regime would soon become hard to respect and would create credibility failures for the new institution inevitably leading to disasters of the League of Nations kind. As he put it in a Statement at a Meeting of the Governors Board, "we risk a setback in the cause of international cooperation".[65]

Although the key currency approach generically called for a closer co-ordination of domestic monetary policies between the leading economies, Williams never explained the way this objective could be practically achieved.

*Optimal currency areas*

His interpretation of the functioning of past monetary system – together with his preference for a two-speed monetary integration – led Williams to believe in the optimality of currency areas which implied the participation of a limited number of countries. As he put it, different kinds of countries require different kinds of monetary systems (Williams 1944b). In his writings, Williams wondered about the optimal degree of internationalism and the formation of currency areas. He thought that the establishment of fixed exchange standards had more relevance for the few advanced countries than for the many "less developed countries". In most cases, their economic system depended on the production of few primary commodities with extremely volatile terms of trade. Moreover, many backward economies were often characterized by a very low degree of trade integration which reduced the potential benefits of a fixed exchange rate regime. Particularly during the presumably long period of transition and reconstruction, small and open economies would have all the advantages in maintaining flexible exchanges as a shock absorber policy instrument. Therefore, for them, greater exchange rate flexibility and control were the most appropriate policy and this was a further point on behalf of the "key currency plan".

US Treasury economists found some merit in this argument, and Edward Bernstein agreed that greater exchange rate variability was needed to offset asymmetric shocks and the deterioration of the terms of trade [Bernstein 1944 and 1968]. However, Williams' proposal was dismissed because it was agreed that less developed countries could get what they needed as insiders of the new international monetary order after consultation with the Fund, rather than as outsiders who decided to act unilaterally. On their part, during the negotiations, small countries with open economies favourably viewed the possibility of adopting a key currency approach to monetary reform. France and Holland presented a lengthy memorandum which sponsored the adoption of Williams's plan. Many countries felt that more time was needed for exchange rate negotiations to be put on a stable and realistic basis.

*Balance of power or hegemony?*

Williams saw geopolitical reasons on behalf of the key currency approach. He was sceptical that the United States was really ready to face their global responsibilities as the world's largest creditor nation. According to the Harvard economist the United States was unwilling to manage its economy in such a way as to assure stability and growth to the rest of the world. He expressed these feelings in his meeting with Keynes with great frankness. "I said we were a creditor country in a very mixed sense […] This makes our problem vastly more difficult than England's in the 19$^{th}$ century. To put it in a few words, we were apt to be self-righteous about currency stability but

[64] J. H. Williams, "International Currency Stabilization. Statement presented to Committee on Foreign Relations of the Federal Reserve Board", 24 September 1943, The Federal Reserve Bank of New York, Williams papers.
[65] Williams' Statement at the Meeting of the Board, September 1943, The Federal Reserve Bank of New York, Williams papers.

unwilling to live up to the obligations of a creditor nations".[66] Also for these reasons, gradualism and flexibility implied by the key currency approach was more fit to steer US administration through the hurdles of isolationism and the like.

## 5. In the heat of the negotiations: Williams, White and Keynes

### *5.1. First reactions*

Williams' proposal was widely debated in the crucial 18 months which went from the first draft of Keynes' clearing union plan to the Bretton Woods conference.[67]

At least in the very early stages of the negotiations, the key currency approach was viewed sympathetically, particularly in British quarters and among experts representing small and open economies (Horsefield 1969, 32ff). Oxford economist Redvers Opie confessed that when the proposal came out he found some attraction in it, although as economic adviser to the British Ambassador in Washington he felt compelled to support the case for a broad international solution [Opie 1957]. In a private correspondence with a Federal Reserve Economist, Roy Harrod recalled to have had a long conversation with Keynes on Williams' project, even before the Clearing Union proposal had been conceived or put into paper.[68] Other British economists thought that some preferential arrangement between the two reserve currencies could usefully become part of the lend-lease agreement and a possible concession against the promised reduction of British trade discrimination. The Bank of England and the British Treasury supported Williams' plan as a prerequisite for the survival of the sterling area. Also Ralph Hawtrey favoured the establishment of a close Anglo-American partnership, with the understanding that each country maintained domestic price stability and mutually supported the exchange rate.[69]

From the outset things were quite different in the Usa where most reactions banned the possible adoption of Williams' proposal from the diplomatic agenda. In particular, the State department never considered the key currency plan as a realistic option to be explored. On the contrary, in order to make article VII of the Mutual Aid Agreement a credible commitment, the State Department required that most nations were to be brought into White's plan on a fully equal basis. The issue – as Roy Harrod recalled in a letter to Rosa – was not "one between the British (or Keynes) and the Americans" and the option on Williams' proposal was never seriously considered: "it was settled by the definite attitude of the State Department, *well before* Williams' proposal [was formulated in detail]. By 1943 it was *chose jujee* (sic!)".[70]

Also the US Treasury and the Federal Reserve Board reacted rather bitterly. On various occasions, the Board attempted to silence Williams and Sproul. An official note was circulated through the Federal Reserve System which cautioned, among other things, that "public expressions of differences of opinion within the System would tend to impair effective representation at the international conference and to destroy any influence that the System might have".[71] On different occasions, at Morgenthau's request, Eccles recommended that Williams desisted from criticism of

[66] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.
[67] See, among others, Beckhart 1944; Bernstein 1944 and 1968; Bogen 1944; Borneuf 1944; Brown 1945; Mikesell 1945.
[68] Harrod to Rosa, 16 May 1949, The Federal Reserve Bank of New York, Williams papers.
[69] Redvers Opie (1957) recalls a "dramatic meeting" with Montagu Norman at the Bank of England in Summer 1943 in which the Governor warned that "to support either the Keynes or the White plan was tantamount to selling Britain down the river". On Hawtrey and the Bank of England, see also Skidelsky 2001, 213.
[70] Harrod to Rosa, May 16, 1949, The Federal Reserve Bank of New York, Williams papers. Emphasis in the original.
[71] As quoted by Meltzer 2003, 620.

White's plan. The Governor's interventions were unusually severe: he threatened not to renew Williams' appointment, tried to prevent his Senate testimony, and finally asked the Board to dismiss him because "his part time job [as vice President and research director] left him free to make public statements". On their part, Williams and Sproul made no commitment to be bound by the Board's position and refused to accept the restriction that their comments remained within the framework established by the official proposals (Meltzer 2003, 523). The New York Fed voted unanimously in October 1943 and June 1944 to endorse the position taken by the two top senior officials.

When the debate heated up, Williams became the leading spokesman for the New York financial community and recurrent references were made in support of his plan. The bankers' conservative attitudes were sympathetic of the more modest approach of the key currency plan, and open tributes were paid to its greater realism and far-sightedness. Williams' plan was more useful in transition; it provided greater prospective stability, easing an extension of the 1936 Tripartite agreement; it proposed ad hoc stabilization agreements tied to gold. Fraser (First National Bank), Riddle (Bankers Trust) and Aldrich (Chase National Bank) were among the most influential bankers who supported the key currency approach. US bankers generally resented having lost control over international monetary affairs when authority was shifted from the New York Fed to the US Treasury under Secretary Morgenthau.[72] In this respect, Williams' rejection of the new international monetary institutions gained open support from the American Bankers Association as a way to reduce the loss of monetary sovereignty. His plan had also some support in Congress, because – as some members saw it – it called simply for a resurrection of the gold exchange standard, with the dollar performing the role that sterling had played previously (Ruggie 1982).

Most of these reactions coincided with the Washington monetary talks of September-October 1943. In the history of the negotiations which prepared the Bretton Woods agreements, this round of meetings between experts remain perhaps the most influential episode. For more than three weeks the two official plans were confronted, readapted and redrafted. By the end of October, both plans were merged into what would become the skeleton of the Joint statement of experts which provided the intellectual and technical background to the Bretton Woods agreements. Only few specific points were still left undecided. When the two delegations adjourned it was agreed that the new international monetary system was to be based on White's Stabilization Fund. In exchange the British delegation obtained important concessions on a number of technical points, the most important of which were a greater amount of exchange rate flexibility, a greater amount of members' contributions, a more rigid maintenance of exchange controls over capital movements, and the approval of more liberal conditions to withdraw from the new institution.[73]

In his accurate reconstruction of this process, L. S. Pressnell has observed that "these informal, non committal talks of September-October 1943 … were the most important Anglo-American exchanges on economic issues not only during the war but also for many years before and since. They were indeed unique; they were conducted at a high intellectual level, ranging frankly over virtually the whole field of economic policy … these talks had a lasting … significance: … they registered and clarified issues and points of agreement " (Pressnell 1986, p.116).

It was at this very crucial stage of the negotiations that Williams had the opportunity to discuss his ideas with Keynes and White. Although Williams was not allowed to participate in the

[72] On this issue the literature is large. See, among others, Fraser 1945; Van Dormael 1978; Garritsen de Vries 1996; Meltzer 2003.
[73] Keynes told Williams that the American delegation had made very generous concessions on these points and that "a good deal of progress was made on this visit". J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.

Washington talks, following Morgenthau's and White's advice Keynes sought to gain the blessing of the Federal Reserve Bank of New York in order to reconcile and strengthen the prospects of Congressional approval. In his visit to the New York bankers Keynes found that they were less obstinately opposed to the idea of an organized fund than had been considered to be the case in Washington. As other British delegates, perhaps Keynes was convinced that most of the problems with the US monetary authorities lay with the decision taken by the Roosevelt administration in the mid-1930s to confer to the US Treasury full powers in the management of monetary policy rather than in an insurmountable opposition to the plan. "The real evil", so James Meade confirmed in his wartime diary, was that central bankers and the financial community "were left so ignorant of the real intentions of the US Treasury" (Howson and Moggridge 1990, 22 Oct. 1943).

In their meetings with Williams, Keynes and White took into consideration some of the arguments of the key currency plan. They both disagreed on the fundamental issue which regarded the two-speed approach, argued that reopening the agreement would not produce a better agreement, but found some merit in Williams' ideas. We will briefly discuss their reactions separately.

*5.2. White's reactions*

On July 1943, two months after the official plans were published and on the eve of the invitation of 46 countries to participate to their discussion, Harry Dexter White wrote to John Maynard Keynes to inform him that Williams' *Foreign Affairs* article on the key currency plan appeared "to be having rather wide distribution". Enclosed to his letter, White sent a copy of Williams' article with the purpose of letting Keynes have the taste "of the kind of opposition there is developing in the United States to efforts for any comprehensive scheme of post-war monetary proposals" (Keynes 1980, 337).

White' reactions to Williams' plans generally followed a geopolitical approach: in most of his comments, he repeatedly noted the existence of many political hurdles which hindered the adoption of Williams' monetary plans. He thought that Williams as well as the advocates of the key currency approach were reasoning in a political vacuum.[74]

First, White thought that it was politically unwise to appear to impose Anglo-American leadership or, to put it otherwise, to leave many European countries outside the Agreement and unable to contribute to the new monetary order. Should the key currency approach be followed, Europe would never be fully integrated into a new multilateral payments system. Second, the adoption of Williams' plan was viewed as a possible threat to dollar supremacy, because it artificially restored an international role for sterling, while it tended to underestimate the financial needs of British reconstruction. To put it more explicitly, White argued that the key currency approach was a gift to England and its desire for some spare hegemonic supremacy. On the contrary, emphasis in the US official plans on free convertibility, multilateralism and stable exchange rates were all designed to limit London's capacity to organize a separate trading bloc, while Williams' plan, which deferred the establishment of a truly international system could be functional to British interests of continued trade discrimination. White also believed that exchange restrictions and discriminatory currency arrangements would be maintained – if not strengthened – by the adoption of the key currency approach which would not guarantee the solution of the scarce currency problem. Finally, as is well known, White was a fervent advocate of eastward enlargement and argued that, for political reasons, China and Russia could not be excluded from the new monetary order.[75]

[74] For a general reference, see Horsefield 1969; Van Dormael 1978; Gardner 1980; Pressnell 1986.
[75] J. H. Williams, "Meeting with Treasury Experts", September 1943, The Federal Reserve Bank of New York, Williams papers.

There were also more technical motivations in the background of White's opposition to the key currency approach. He believed that it was likely to lead to the establishment and perpetuation of closed trading systems with trade between these system conducted on a bilateral rather than on a multilateral basis.[76] He also noted that too many countries could have their own key currency with respect to single commodities while non-key currency countries accounted for over 75% of world trade. Moreover, the absence of an international organization – which the key currency approach implied – rendered more difficult the adoption of common rules and standards with respect to exchange and foreign investment practices. On this issue, he strongly affirmed that the Fund had essential functions to perform during the period of transition. Although the demand for reconstruction loans could not be satisfied, nevertheless the new institution could usefully operate to re-establish world confidence in a system of orderly exchange rate variations. Finally, together with other American economists, White expressed his conviction that the key currency approach bore too close a resemblance to the Norman plan which dramatically failed to bring results in the 1920s. If Britain was granted the status of "key country" she was quite likely to refuse to participate in major programmes of external financing because foreign loans would drain resources and produce deflation and unemployment at home.[77]

White also stated that the most convincing aspects of the key currency plan were already embodied in his proposal.[78] The dollar was bound to become the key currency of the new system. His plan provided some safeguards against the risks of a premature participation of countries which were not yet qualified to operate with the IMF: the new institution, in fact, had the powers to delay the beginning of lending operations with particular areas or countries, and it could arrive to the decision to refuse to fix the initial parity.[79] On matters of exchange rate policy, White believed that Williams' plan would excessively increase exchange rate flexibility and provide incentives to ease unilateral alterations of exchange rates (Horsefield 1969, 84). On this point, he feared that the British delegation might see some reasons to recognize the cogency of Williams' ideas. However, Keynes promptly reassured White that he no longer had a strong faith in the expansionary role of exchange rate depreciations and that the British would not support Williams' plan on this issue.

### *5.3. Keynes's reactions*

Keynes's critical reactions to Williams' proposal were in part inspired by reasons of political opportunity and in part by theoretical conviction.

As the negotiations preceded, Keynes was persuaded that the official plans should never be intended to deal with transition problems.[80] However, in his conversations with Williams, Keynes insisted that the institutional machinery for the long run should have been put into operation

[76] Alvin Hansen and Dennis Robertson agreed on this point (see Hansen 1944, 30). They dismissed Williams plan since it implied the danger of formation of a currency bloc and promote the splitting up of the world into economic blocs which involved discrimination in trade and currency matters.
[77] On these themes, see also Bernstein 1944.
[78] J. H. Williams, "Notes on a meeting with Treasury experts", 10 September 1943, The Federal Reserve Bank of New York, Williams papers. Influential governor of the Bank of Canada, Louis Rasminsky, shared White's fears and expressed his belief that the important core of truth in the key currency approach would not be lost in the Fund arrangement. See his July and August 1943 correspondence with Williams in Archives of The Federal Reserve Bank of New York, Williams papers.
[79] J. H. Williams, "Notes on a meeting with Treasury experts", 10 September 1943, The Federal Reserve Bank of New York, Williams papers.
[80] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers. In December 1943 Keynes wrote a letter to White in which he proposed a joint appeal for devising a separate programme of transitional finance. See Gardner 1980, 117.

immediately after the war. Only in this way could international multilateralism in trade and finance be effectively restored. He gave several reasons which largely depended on political opportunity rather than on its greater technical efficiency. As he confessed to Williams, "one was the familiar one that we now have the opportunity, if ever, and if we wait we may lose it. Another was that there had now been so much consulting of other governments that both the British and the American Treasury feel that there can be no turning back. Another was that there will be work for the stabilization plan to do even from the outset, that some countries will already be in proper shape for it, and here he mentioned the United States, the Dominions, the Latin American countries, and England (assuming that England has found ways for handling her immediate problems)".[81]

In his October 1943 meeting with Williams, Keynes also put it very clearly that Britain and sterling no longer held a key position in international trade and finance. To restore its role as a key country she needed US assistance while he guessed that she would prefer to apply to the Fund and reap the advantages of anonymous borrowing rather than "come to us with her hat in her hand and ask for help".[82] As a founding member of the new Stabilization fund Britain may be able to aggregate consensus from small countries and would not always prefigure a subordinate role dependent on American loans.[83] This point had already been dealt upon at a meeting of Treasury experts in September 1943 where a further concern was raised against the adoption of the key currency plan:[84] it was observed that the divergent rates of the various pounds showed that the members of the sterling area were already pursuing independent monetary policies while Britain was not in a position to dictate policy rules to the sterling area as she might be required to do under the key country approach. Finally, Keynes added that particularly the Bank of England and Montagu Norman had not been keen in entering into a borrowing arrangement with the US, "they couldn't live up to".[85] In many British quarters it was hoped that the new institution and the world bank could provide some more generalized borrowing arrangements.

However, unlike White's, Keynes' remarks against the possible adoption of the key currency plan also depended on its technical features.

In their meetings, Keynes expressed some appreciation with several aspects of Williams' critical campaign against White's stabilization plan. Keynes agreed that the Fund's resources were rather disappointing in relation to the future growth prospects of world trade and that the surrender of sovereignty was too marginal. Keynes explicitly agreed that the Fund's machinery was not a cure for every post-war problem and that loans from the Fund had never been conceived of as something vital for western European reconstruction, but rather "as oil for the machinery… breathing space".[86] Keynes also agreed with Williams that the discipline of conditionality was the really weak point in the Joint Statement and that it was bound to remain the burning issue of the Fund's operations for a long time. In their private conversations he justified the vagueness of many clauses regarding the principle of conditionality in terms of their political feasibility. In fact, discussing this issue with Williams, Keynes observed that the Fund "would not last two years if it were butting into domestic

[81] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.
[82] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.
[83] J. H. Williams, "Notes on a meeting with Treasury experts", 10 September 1943, The Federal Reserve Bank of New York, Williams papers. According to some interpreters, Keynes operated with myth that Great Britain would continue to be an influential if not a dominant economic power in the post-war world.
[84] J. H. Williams, "Notes on a meeting with Treasury experts", 10 September 1943, The Federal Reserve Bank of New York, Williams papers.
[85] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.
[86] J. H. Williams, "Memorandum on a Meeting of the Board of Directors", 17 August, 1944, The Federal Reserve Bank of New York, Williams papers. Keynes was also present.

policies": he did not think "England or any other country would accept interference with its domestic policies".[87] Quite to the contrary, in an effort to increase its authority and independence during the first period of operations Keynes thought that the Fund must be "kept clear of internal problems but it is entitled (though he should be careful) to make a report as to what it considers the cause of the basic disequilibrium".[88] Therefore, Keynes agreed with Williams' basic observation that much work and a lot of time were required in order to make the new commitments realistic and efficient. He objected, however, that the new system could not contemplate the gradualism implied by the key currency approach nor the maintenance of flexible exchange rates for all other members. On this point, Keynes confessed to Williams that he had little faith in the use of exchange rate variations as a macro stabilization instrument. Contrary to what he had advocated in the early 1920s, he favoured exchange stability, agreed that nations ought to preserve some measure of freedom to change the parity but thought that this freedom had to be used very rarely, and "only when it was clearly proved that this is the best method of adjustment".[89]

In line with Williams' philosophy, Keynes admitted his support for the redefinition of the nature of the general commitment in order to reduce its stringency and increase its credibility among member countries. Member countries would be persuaded to take all the necessary measures to respect soft but realistic commitments. Keynes believed that an opt-out clause might help: "one way to do it was not the key currency approach but to allow free right to withdraw". In fact, this concession would lessen fears of member countries "about the extent of their commitment and encourage a general acceptance of the plans, and that afterwards, when they were in, they would find themselves under a strong moral compulsion to stay in and work out their differences within the framework of the plans".[90] Williams replied that this was a good point but still thought that the risk of failure of the new institutions should not be minimized. Countries might even go "to the length of destroying the plan, and the world could not stand another fiasco in the field of international cooperation".[91]

Keynes consulted with Williams on a number of issues. They found themselves in complete agreement on the opportunity to grant member countries freedom to maintain exchange controls. In Williams' written memories of their first meeting, it was at this point that Keynes admitted that one further reason for controversy with the American administration remained the question of exchange control. Keynes spoke against the US Treasury view which pressed for the earliest possible abandonment of all currency restrictions. On the contrary he favoured a high level of post-war planning of foreign trade and exchange transactions, warning against the feasibility of any distinction between the capital account and the current account. As he put it, the control of capital movements implied an overall system of exchange control: what had been learnt in the 1930s should not be dispersed in the post-war world and British authorities had acquired strong reputations in the effectiveness of controls. As Williams recalled,

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[87] The first Keynes' quotation is taken from J. H. Williams, "Memorandum on a Meeting of the Board of Directors", 17 August, 1944, while the second is taken from J. H. Williams ,"Our Meeting with Keynes", 20 October 1943. Both documents are in The Federal Reserve Bank of New York, Williams papers.

[88] J. H. Williams, "Memorandum on a Meeting of the Board of Directors", 17 August, 1944, The Federal Reserve Bank of New York, Williams papers. Keynes was also present.

[89] On his part, Williams openly confessed his surprise to learn that on matters of exchange rate policy lord Keynes had completely different views from the John Maynard Keynes he had read for the last 10 years. Quite likely, Keynes referred to Meade's proposal for an objective test of exchange rate variations which the LSE economist had brought to the attention of the Committee on trade policy. See, on this point, Howson and Moggridge 1990 and Horsefield 1969. Keynes' views on the efficacy of exchange rate policy are again taken from J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.

[90] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.

[91] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.

Keynes said he thought he had done some educating of our Treasury on this point, that his assistant (I think he said Mr Ausland) was a Bank of England man who understood their exchange control thoroughly, and he had been taken Bernstein aside and apparently having considerable effect upon him. Keynes said that the British view now is that we must control capital movements and cannot do so without an over-all exchange control. The transactions that they wish to leave free they authorise under a general license, but all transactions have to be reported. He urged us strongly to send a man over to the Bank of England to study their exchange control.[92]

Williams and Keynes agreed on the relatively greater efficacy of direct methods of intervention, which ranged from import quotas to voluntary export restraints on the part of creditor countries. Again, in Williams' memories "we asked whether under his scheme there could be also a control of exports of merchandise, and Keynes replied that he didn't see why not if that were really necessary. All this interested me very much".[93] They also agreed on the need to avoid the blocking of foreign assets in order to stimulate direct investments. "What we need, therefore, is a partial control, giving a country control over its own capital, and this would probably be sufficient to handle the hot money problem".[94]

However, for what concerned the official plans under discussion, unlike Williams Keynes saw many positive externalities in the establishment of a Stabilization Fund. He thought that the Fund would contribute to strengthen international co-operation and the quality of information in monetary affairs, thus increasing the efficacy of monetary policy. The Fund would perform its role of international monetary management with increasing authority and soon become "the platform where central banks will come together and consider matters of public interest".[95] The new institution could usefully become "the current barometer and give clear warnings on changes in weather conditions". In terms of its technical mechanics, Keynes strongly rebutted Williams' criticism affirming that the Fund would provide "a code of conduct with regard to exchange practices and orderly methods of making exchange changes and to constitute a consultative body".[96] He anticipated that the Fund would become an international body with "considerable authority" over the manner in which exchange rate variations were determined. At the current stage of the negotiations Keynes strongly affirmed that a withdrawal was no longer possible unless a loss of prestige would undermine any future plan for institutional design.

Williams remained quite unconvinced by Keynes' arguments in defence of the Fund. He replied that the art of central banking was based on selectivity while the Fund's approach was too general and unconditional. On this occasion he spoke in favour of the Clearing Union plan as a real piece of institutional innovation and international monetary authority. What was really needed was a bank with full corrective powers which were exercised through interest rate policy and discretion. Keynes replied that while quotas were maxima of right, the Fund had the authority to increase them

[92] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.
[93] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.
[94] J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.
[95] J. H. Williams, "Memorandum on a Meeting of the Board of Directors", 17 August, 1944, The Federal Reserve Bank of New York, Williams papers. Keynes was also present.
[96] J. H. Williams, "Memorandum on a Meeting of the Board of Directors", 17 August, 1944, The Federal Reserve Bank of New York, Williams papers. Keynes was also present. See also J. H. Williams ,"Our Meeting with Keynes", 20 October 1943, The Federal Reserve Bank of New York, Williams papers.

and even to create new means of international liquidity. These decisions largely depended on its authority, independence of judgement and reputation.[97]

## 6. Conclusions

Williams' plans and activities for a new monetary order were part of one of the most fascinating episodes in the history of economic ideas and policy making.

In this paper we have tried to show Williams' main contributions as an international economist and monetary reformer. In particularly, we have briefly explored the analytical rationale of his key currency approach and the reasons why Williams fiercely campaigned against the two official plans which represented the intellectual background to the Bretton Woods agreements. To do so, we have shown how his policy proposals were the outcome of his doctrinal rejection of the two main tenets of classical economics in the international field: namely, the Ricardian theory of comparative advantages and the gold standard. From his early academic writings Williams found inspiration to create a stabilization plan which put special emphasis on the unequal size and importance of national countries, on the international repercussions of key countries' domestic economic policies, and on the disturbing effects of international capital movements. We have also shown the many and prestigious reactions which Williams' plan managed to provoke, together with the contents of his conversations with Keynes on the pros and cons of the monetary system under construction. Analysis of their conversations has led us to conclude that the two economists had convergent views on a great number of issues which regarded the new architecture of the world monetary system. Keynes clearly admitted that political reasons prevented the British delegation from considering more carefully the inclusion of Williams' plan in the diplomatic agenda, the most relevant being that Britain no longer held a "key country" position in the post-war world.

From this reconstruction, what general conclusions can be drawn?

Williams was able to foresee many problems of the post-war world. He correctly anticipated that the post-war world would for a long time still be dominated by renewed forms of bilateral and payments agreements and that to be successful all efforts towards the restoration of convertibility and outright multilateralism needed time, strong leadership and a lot of "green cheese". He was also right to anticipate the failure of the Morgenthau-White international economic policy and its substitution with a policy that recognized the reality of American hegemonic power and political interests. For a long time, the United States operated unilaterally outside the institutions they had worked so hard to establish. The International Monetary Fund particularly remained inactive during the transition.

At least indirectly, Williams succeeded in contributing to the significant improvement of the negotiations which were ultimately marked by the publication of the Joint Statement of Experts in April 1944. The Joint Statement clearly recognized the difference between the transition years and the long run; recognized the difference between exchange rate stability and exchange rate rigidity; approved the maintenance of national forms of active controls over capital movements. All these issues became evident during the October 1943 money talks and contemporary discussions on Williams' plan helped to bring them to light.

[97] See again Williams' recollections of his discussion with Keynes in J. H. Williams, "Memorandum on a Meeting of the Board of Directors", 17 August, 1944, The Federal Reserve Bank of New York, Williams papers and Williams 1944b.

One final point which was somehow related to the key currency approach was conditionality. Undoubtedly, discussions on conditionality and the dollar shortage were stimulated by Williams' writings even though further research efforts might help to clarify this point. In his writings he urged that the Fund's modest financial resources should not be used to liquidate the war-time indebtedness. Gaining strong consent in financial quarters – beginning with the open blessing coming from the American Bankers Association – Williams feared that the International Monetary Fund would be called on a policy of making doubtful loans in order to defend the fixed parity of weak currencies. Automatic lending procedures would increase the Fund of poor currencies and decrease its holdings of valuable assets, running the risk of repeating the disastrous free lending policies of the 1920s which ultimately brought about a sudden reversal and a crisis. In line with Williams' writings, the final articles of the Bretton Woods agreement recognized that the Fund was not intended to provide facilities for relief or reconstruction or to deal with international indebtedness.

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