

## CONCEPT: THE BRETTON WOODS SYSTEM

- The **Bretton Woods system** was an exchange rate system implemented after the abandoning of the Gold Standard
  - This system was used from 1944 to 1973
  - At the Bretton Woods international conference, the US pledged to buy or sell gold at a fixed rate of \$35/ounce
    - > Countries pledged to buy and sell their currencies at a fixed rate against the dollar
      - This also fixed exchange rates between other countries as well
    - > Unlike the gold standard, no country was willing to exchange its paper money for gold
      - The US would only redeem dollars for gold if presented by a foreign central bank
      - From the 1930s-1970s, it was actually illegal for American citizens to own gold, except jewelry
    - > Foreign countries were committed to holding *dollar reserves*
      - **International Monetary Fund (IMF)** provided loans to central banks short of reserves
  - Since exchange rates were fixed, the forces of supply and demand were not at play
    - > The fixed exchange rate did not necessarily equal the equilibrium exchange rate
    - > This led to surpluses and shortages of currencies
    - > The IMF would note a persistent surplus or shortage and adjust the fixed exchange rate accordingly
- The Bretton Woods system collapsed due to two main problems
  - By 1963, the dollars held by foreign central banks exceeded the gold reserves of the United States
    - > Though central banks rarely redeemed the dollars for gold, this was the foundation of the system
    - > As the gap grew larger, central banks began to doubt the USA's promise to redeem dollars for gold
  - Some countries with undervalued currencies were unwilling to revalue their currencies
    - > An increase in their currency's value would lead to higher prices for their exports
    - > Firms pressured their governments not to allow the exports to fall due to higher prices
  - Eventually controlling the fixed exchange rates between the countries became too difficult
    - > In 1971, President Richard Nixon abandoned the USA's commitment to redeem dollars for gold
    - > By 1973, the Bretton Woods system was abandoned and a "managed float system" emerged