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As international pressures build to create a new international financial and currency order in the wake of the most severe global crisis since the 1930s, interest—and fantasy—center not only on the critical role of the United States but equally on China. China is now in the spotlight not only because of its position as a rising economic power, not only because of its vast financial currency reserves in the range of \$2 trillion, but also because of currency strategies that align the yen to the dollar to keep its value low in order to maximize exports. Here Sebastian Mallaby looks back and forward to envisage a new financial order that would place China at the center. Japan Focus

There wasn't much to see in Bretton Woods in July 1944, when delegates from 44 countries checked into the sprawling Mount Washington Hotel for the United Nations Monetary and Financial Conference. Almost a million acres of New Hampshire forest surrounded the site; there were free Coca-Cola dispensers, but few other distractions.



The Mount Washington Hotel. site of the Bretton Woods Conference

In this scene of rustic isolation, 168 statesmen (and one lone stateswoman, Mabel Newcomer of Vassar College) joined in history's most celebrated episode of economic statecraft, remaking the world's monetary order to fend off another Great Depression and creating an unprecedented multinational bank, to be focused on postwar reconstruction and development.



Delegates at the 1944 conference in Bretton Woods, N.H.

At the Final Plenary, a sea of black-tied delegates gave a standing ovation to British economist John Maynard Keynes, whose intellect had permeated the three weeks of talks. Lord Keynes paid tribute to his far-seeing colleagues, who had performed a task appropriate "to the prophet and to the soothsayer."

The Bretton Woods conference has acquired mythical status. To economic-history buffs, it's akin to the gathering of the founding fathers at the constitutional convention. To politicians anxious to make their marks upon the world, it's a moment to be richly envied. The recent calls from British Prime Minister Gordon Brown and French President Nicolas Sarkozy for a new Bretton Woods conference, to which the Bush administration has acceded, have caused TV crews to descend upon the old hotel, which has undergone a \$50 million facelift. But Bretton Woods revivalism is nothing new. Indeed, it's a long tradition.

After the onset of the Latin debt crisis in 1982, U.S. Treasury Secretary Donald Regan floated the idea of a new Bretton Woods to steady the hemisphere's currencies. The following year, reeling from three devaluations of the franc, French President Francois Mitterrand declared, "The time has really come to think in terms of a new Bretton Woods. Outside this proposition, there will be no salvation." Mitterrand persisted in this grandiloquence over the next two years. He finally quieted down in 1985, when Margaret Thatcher dismissed his proposal as "generalized jabberwocky."

In the wake of the emerging-market crises of 1997-98, Bretton Woods nostalgia broke out again -- this time in post-Thatcher Britain. "We should not be afraid to think radically and fundamentally," Tony Blair opined. "We need to commit ourselves today to build a new Bretton Woods for the next millennium." The precise

content of Mr. Blair's millennial ambition was, shall we say, vague. But no fellow leader was rude enough to say so.



French President Nicolas Sarkozy (left) with British Prime Minister Gordon Brown earlier this month

Among acts of international economic statesmanship, perhaps only the Marshall Plan has been invoked more frequently. There have been calls for a Marshall Plan for postcommunist eastern Europe, a Marshall Plan for Africa, a Marshall Plan for the inner cities. Indeed, anybody wanting Washington to splurge finds Marshall exceedingly convenient.

But Bretton Woods has a richer and more rarefied cachet. It was about reordering the international system, not just mobilizing money for an enlightened cause. And whereas the Marshall Plan was an example of the unilateralism for which the U.S. is known, the Bretton Woods conference was a triumph of multilateral coordination. It featured countries as diverse as Honduras, Liberia and the Philippines (Keynes spoke disdainfully of a "most monstrous monkey-house"), though it did not include South Korea or Japan, important voices in today's economic summitry.

Both sides of the Bretton Woods achievement seem alluring today, yet both may be chimerical. The conference rebuilt the economic order by creating a system of fixed exchange rates. The aim was to prevent a

return to the competitive devaluations best illustrated by the "butter wars." In 1930 New Zealand secured a cost advantage for its butter exports by devaluing its money; Denmark, its main butter rival, responded with its own devaluation in 1931; the two nations proceeded to chase each other down with progressively more drastic devaluations.

This beggar-thy-neighbor behavior added to the protectionism that brought the world to ruin, and the Bretton Woods answer was simple. In the postwar era, the dollar would be anchored to gold, and other currencies would be anchored to the dollar: No more fluctuating money, ergo no competitive devaluation. To undergird this system, the Bretton Woods architects created the International Monetary Fund, which was far more central to their ambitions than their other legacy, the World Bank. If a country's fixed exchange rate led it into a balance of payments crisis, the IMF would bail it out and so avert devaluation.



John Maynard Keynes addressing the delegates

Today the idea of another monetary rebirth has much to recommend it. The credit bubble that has wreaked havoc on the world's financial markets has its origins in a two-headed monetary order: Some countries allow their currencies to float, while others peg loosely to the dollar. Over the past five years or so, this

mixture created a variation on the 1930s: China, the largest dollar pegger, kept its currency cheap, driving rival exporters in Asia to hold their exchange rates down also. Thanks to this new version of competitive currency manipulation, the dollar-peggers racked up gargantuan trade surpluses. Their earnings were pumped back into the international financial system, inflating a credit bubble that now has popped disastrously.

Persuading China to change its currency policy would be a worthy goal for a new Bretton Woods conference. But currency reform is low on the agenda of the summit that the Bush administration plans to host on Nov. 15. (The administration styles this gathering a "G-20 meeting," ignoring the European talk of a Bretton Woods II.) The British and French leaders who pushed for the meeting want instead to talk about financial regulation -- how to fix rating agencies, how to boost transparency at banks and so on. But many of these tasks require minimal multilateral coordination.



Henry Morgenthau and H.H. Kung, heads of the U.S. and Chinese delegations at Bretton Woods talk with reporters

If the Europeans shrink from demanding that China cease pegging to the dollar, it's perhaps because they anticipate the concession that

would be asked of them. China isn't going to give up its export-led growth strategy for the sake of the international system unless it gets a bigger stake in that system -- meaning a much bigger voice within the International Monetary Fund and a corresponding reduction in Europe's exaggerated influence. When you strip out the blather about bank transparency and such, this is the core bargain that needs to be struck. Naturally, the Europeans aren't proposing it.

It will be up to the two great powers -- the U.S. and China -- to fashion the deal that brings China into the heart of the multilateral system. Here, too, is an echo of the first Bretton Woods, for underneath the camouflage of a multilateral process there was a bargain between two nations. Britain, the proud but indebted imperial power, needed American savings to underpin monetary stability in the postwar era; the quid pro quo was that the U.S. had the final say on the IMF's design and structure. Today the U.S. must play Britain's role, and China must play the American one.

There's a final twist, however. In the 1940s the declining power practiced imperial trade preferences; the rising power championed an

open world economy. When Franklin Roosevelt told Winston Churchill that free trade would be the price of postwar assistance, he was demanding an end to the colonial order and the creation of a level playing field for commerce. "Mr. President, I think you want to abolish the British empire," Churchill protested. "But in spite of that, we know you are our only hope."

Today it is the rising power that pursues mercantilist policies via its exchange rate. China's leadership, which sits atop an astonishing \$2 trillion in foreign-currency savings, could trade a promise to help recapitalize Western finance for an expanded role within the IMF. But China may simply not be interested. The future of the global monetary system depends on whether China aspires to play the role of Roosevelt -- or whether it prefers to be a modern Churchill.

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