Folder Title:	Bretton Woods Documents - Hackett Comments on Bretton Woods - Comments
Folder ID:	1849711
Series:	Bretton Woods collection
Dates:	03/05/1945-03/05/1945
Sub-Fonds:	Leonard B. Rist files
Fonds:	Records of Individual Staff Members
ISAD Reference Code:	WB IBRD/IDA STAFF-09-02
Digitized:	6/24/2020

Bretton Woods Documents - Hackett Comments on Bretton Woods

Mar. 5 1945

DECLASSIFIED
WBG Archives

B.W. by Hackett, 45

35 Cents

bretton woods

by

W. T. G. HACKETT

THE CANADIAN INSTITUTE OF INTERNATIONAL AFFAIRS
230 Bloor Street West, Toronto 5

BRETTON WOODS

The Proposals for an International Monetary Fund and an International Bank for Reconstruction and Development

by

W. T. G. HACKETT

Economic Adviser, Bank of Montreal

The Canadian Institute of International Affairs is an unofficial and non-political body founded in 1928 to promote an understanding of international questions and problems, particularly those which affect Canada and the British Commonwealth and Empire. The Institute, as such, is precluded by its Constitution from expressing an opinion on any aspect of public affairs. The views expressed herein are those of the author.

The Institute has an expanding public education programme which embraces Teachers' Seminars and the publication of popular pamphlets on current affairs, a free public Information Service and a Library designed to assist scholars, teachers, students, journalists, businessmen, librarians, study group leaders, and all other interested people. The National Office publishes Research volumes, the Contemporary Affairs series of research pamphlets, the Behind the Headlines series of topical pamphlets, a special series of pamphlets on other topical problems. The Institute holds study conferences and takes part in international conferences as the Canadian Council of the Institute of Pacific Relations and also as one of the Institutes of International Affairs which are located in Commonwealth countries.

Toronto,
March 5, 1945

Douglas MacLennan,
National Secretary

Printed by Associated Printers Ltd., 64 Duke St., Toronto

FOREWORD

In the present pamphlet Mr. W. T. G. Hackett, with admirable clarity, traces the development, describes the chief features, analyzes the implications, and discusses the reception, in Canada and abroad, of the proposals formulated at Bretton Woods. His analysis makes abundantly clear that, while the techniques of currency and credit are primarily involved, beyond them and affected by them are the major issues implicit in creating a firmer and more enduring international economy. The institutions and procedures proposed at Bretton Woods are intended to promote international trade and investment on something like a free market basis but differently from international action in the past. If there is failure to implement these or similiar proposals, the alternative is likely to be widespread bilateralism, involving many government controls and regional agreements, with the inevitable rigidity of such controls and their abundant stimulus to economic nationalism. It should require no emphasis that Canada has a profound concern in the plan of Bretton Woods, and Mr. Hackett's pamphlet will provide guidance to those who wish to grasp its meaning.

Mr. Hacket is Economic Adviser to the Bank of Montreal, but his views and interpretations in this pamphlet are, of course, purely his own.

ALEXANDER BRADY,
Chairman of the Research Committee

BRETTON WOODS

The layman, anxious to keep abreast of current developments, may well experience some bewilderment as he approaches the Bretton Woods proposals. Canadian public comment on the subject has not been extensive. But in the United States and in the United Kingdom there is a large and growing body of discussion by public officials, bankers and economists, with respect to the proposed International Monetary Fund and International Bank for Reconstruction and Development. Much of this discussion has been of a highly controversial nature; some of it, poles apart in approach and conclusions. Comment has centred principally around the Monetary Fund, not because that organization is more important than the Bank, but because of the two flowerings of Bretton Woods, the Monetary Fund is certainly the more exotic growth—more unconventional and therefore more provocative of argument.

If the layman, desiring to go back to original sources to form his own conclusions, essays an examination of the Fund and Bank plans themselves as embodied in the *Final Act* of the Bretton Woods Conference, his bewilderment is not likely to be lessened. For he will find that both these plans, set out as working by-laws of the respective organizations, are couched in peculiarly difficult phraseology. The individual not fairly familiar with the technical jargon of international monetary economics may well lay aside the documents in despair. Even the technician will have to go very slowly at some points.

This pamphlet, therefore, is intended to provide first, a summary of the essential operating features of the Bretton Woods proposals. Secondly, an attempt will be made to survey and assess the arguments for and against the Fund and the Bank as they have emerged in the course of the past six months. In the final pages of the pamphlet, brief reference is made to some aspects of the Bretton Woods proposals in their specific relationship to the Canadian situation.

THE GENERAL AIMS

The International Monetary Fund

The International Monetary Fund has a fourfold objective.

First: The Fund would provide permanent machinery for consultation and collaboration on international monetary matters.

Second: The Fund would be an association for the maintenance of orderly exchange relationships between the currencies of the various member nations.

Third: The Fund would work towards the elimination of exchange control on international transactions except those of a capital nature.

Fourth: The Fund would provide a means whereby member nations, under certain specified conditions, may obtain short-term credit accommodation to finance their purchases from abroad. It is fundamental to the plan that such credit facilities should make it unnecessary for a member nation, faced with a temporary dislocation in its balance of international payments, to resort to drastic deflationary measures as a corrective. Nor as an alternative should such countries be driven to competitive currency depreciation, specific limitations on imports (which are some other country's exports) and other devices of a distress nature. Implicit in the plan is recognition of the fact, amply illustrated by the course of economic history between the two wars, that all such distress measures are contagious. Drastic deflation in any one country, in so far as it limits imports, cannot fail to have repercussions upon the rest of the world; and if the country suffering the deflation is normally a large importer the repercussions on the position of other nations may be extremely serious. Further, attempts to stimulate exports by competitive currency depreciation, multiple currency

devices, limitation of imports by quotas, prohibitions, and the like, only invite retaliatory or protective measures on the part of other countries. The result is to diminish the aggregate of world trade, to the ultimate disadvantage of all nations, including those whose balances of payments are favourable.

It should be emphasized that the credit accommodation provided by the International Monetary Fund is both conditional and limited. In the words of Lord Keynes, it is an "iron ration" not "daily food".[1] It is not the function of the International Monetary Fund to attempt to bolster up indefinitely, through the extension of credit, a situation in which adjustments by other means are desirable and/or inevitable.

Implicit in the operating principles of the Fund is another proposition that is a corollary of the foregoing. Just as a deficiency in a nation's balance of international payments is something which is regarded as undesirable and which the Fund will assist in adjusting, so are chronic tendencies for a country to accumulate a favourable balance of payments just as much to be deplored. They are indeed the obverse of a reverse situation in some other country or countries and call for offsetting by appropriate policies.

The International Bank for Reconstruction and Development

The International Bank for Reconstruction and Development is designed to facilitate the international investment of capital for specific reconstruction and/or developmental projects carried out and financed under specified terms and conditions. The proposal is grounded upon the assumption that while the post-war need for international investment will be substantial, the required funds are not likely to be forthcoming without some adequate means of pooling the investment risk. Moreover, while, in the early post-war years at least, only a very few countries will be able to

[1]Lord Keynes, address to House of Lords, May 23, 1944. "They (the Monetary Fund quotas) are not intended as daily food for us or any other country to live upon during the reconstruction or afterwards. . . . The quotas for drawing on the Fund's resources are an iron ration to tide over temporary emergencies of one kind or another."

assume the role of foreign lender, yet the resultant flow of international capital will, directly or indirectly, redound to the benefit of all. Hence, it is a basic principle of the Bank organization that no matter what country actually does the foreign lending, all the member nations should participate in the risk involved.

While the Bank will be empowered to make direct loans out of its own subscribed capital, such a procedure will be the exception rather than the rule. The typical transaction will probably be a loan made through the ordinary channels of foreign investment but guaranteed as to repayment by the International Bank for Reconstruction and Development. In the event of default and ultimate loss, such loss is distributed among the other members of the Bank on the *pro rata* basis of their capital subscription.

It will be seen that while the Fund and the Bank perform separate functions, their respective areas of action and responsibility are complementary. Moreover, each institution, properly functioning, would assist the successful operation of the other. An outward flow of foreign investment from creditor countries can do a great deal to prevent the distortions and dislocations in the balances of payments of debtor countries, thereby reducing the need for accommodation through use of the resources of the Fund. On the other hand, the existence of a mechanism designed to minimize exchange rate fluctuations, and to provide short-term international credit accommodation when and where necessary, should help to provide an atmosphere more conducive to successful long-term foreign investment. Both Fund and Bank are expansionary in concept. The basic purpose of both institutions is to facilitate and maximize international trade—to provide means whereby interchanges of goods and services may take place that would not otherwise be possible.

THE PREPARATORY WORK

Before going on to consider the operative procedures of the Fund and Bank, something should be said of the various

preliminary steps leading up to the formulation of the plans as they now exist.

The plans for the Fund and the Bank are definitely not documents thrown together in a hurry by a group of government officials in the course of three weeks at a New England resort hotel. On the contrary, the proposals in their present form represent the culmination of a great deal of preliminary thinking and painstaking work extending over more than a two-year period. In April 1943 the matter of post-war currency stabilization was for the first time brought formally before the public through the almost simultaneous publication of two sets of proposals. On the direction of H.M. Government, United Kingdom Treasury experts published proposals for an international clearing union, which proposals subsequently became popularly known as the "Keynes Plan". The essence of this plan was that each member, subject to certain conditions, would be allowed overdraft facilities, expressed in terms of an international currency, on the books of the Union, which currency could be used only for making transfers within the Union, and which members would undertake to accept in settlement of international balances. The other plan, popularly known as the "White Plan,"[1] was put forward by United States Treasurer experts. This envisaged a fund to which members would subscribe gold and currencies which could be used for temporary credit accommodation to member nations.

Both plans set specific terms and conditions governing the variation of exchange rates, the Keynes proposals being the more liberal in this respect. Of the two plans the Keynes document was considerably more ambitious in concept, particularly with respect to the potential lines of credit extended to debtor nations by creditor nations. For example, assuming a theoretical situation in which the United States were the only nation with a credit in its balance of international payments, all the other members having debit balances, the United States would have been liable for a commitment of about $30 billions under the Keynes plan as compared with about $2.5 billions under the White plan.

[1]For H. D. White, Assistant to the Secretary of the Treasury.

In July 1943 Canadian Government experts came forward with a plan which it was hoped would provide an acceptable compromise between divergent features of the two preceding schemes, but which in general structure adopted the "fund" rather than the "clearing union" approach. A few days later in the same month, a revised United States Treasury Plan was issued. All of these plans were tentative, with the three governments concerned being in no way directly committed.

In ensuing months, a plan for international monetary stabilization was the subject of literally hundreds of conferences between United Nations' experts.[1] These deliberations culminated in April 1944 in a statement by technical experts of the United Nations upon an agreed set of basic principles for an International Monetary Fund. This set of basic principles, along with certain unpublished proposals for an International Bank, went on the agenda of the United Nations' Monetary and Financial Conference held at Bretton Woods, New Hampshire, from July 1st to July 22nd, 1944.

As the *Final Act* of the Bretton Woods Conference, there emerged detailed *Articles of Agreement* of an International Monetary Fund and of an International Bank for Reconstruction and Development. The *Final Act* was signed by representatives of each of the 44 United Nations, each signature, however, carrying the general reservation that assent was subject to subsequent approval and ratification of the government concerned. Several countries, notably Russia, France, India, Australia, and the United Kingdom (this last on the very minor point of the location of the Head Offices of the two bodies) put in specific reservations none of which were sufficiently serious to prejudice the practical working out of the proposals involved.

Included in this *Final Act* are recommendations on a number of other matters. The Conference recommended that the Bank for International Settlements be liquidated at the earliest possible moment. The Conference also recommended to the participating governments that in addition to implementing the specific proposals for a Monetary Fund and an

[1]See: H. D. White, "The Monetary Fund: Some Criticisms Examined", *Foreign Affairs,* January 1945, for a description of preliminary conferences.

International Bank, they go on to seek ways and means of reducing trade barriers, achieving arrangements for orderly marketing of staple commodities, dealing with special problems of international concern, and harmonizing national policies of member states designed to promote and maintain high levels of employment and progressively rising standards of living.

The *Final Act* contains a list of the delegates to the conference. For the most part, as was undoubtedly appropriate, these were government officials. Nevertheless, one cannot but feel that some effort might usefully have been made to include in the expert personnel some representatives of commercial banking and private finance. The United States had one such delegate in the person of Mr. Edward E. Brown, President of the First National Bank of Chicago. The United Kingdom and Canada had no such delegates. It is more than possible that a broadening of the delegations in such a manner would have contributed materially to a wider and better public understanding of the issues involved and the measures proposed.

OPERATING FEATURES OF THE INTERNATIONAL MONETARY FUND

In this section, and in the section immediately following, dealing with the Bank, an attempt will be made to sketch, in broad outline, the operating features of the two organizations. All the noteworthy details cannot be summarized within the compass of this pamphlet; hence those which are of secondary significance, and of technical interest only, will not be mentioned.

Membership and Quotas

Membership in the International Monetary Fund is initially open to the 44 United Nations. In order to provide the Fund with working assets, each of these members will contribute a quota to the Fund; and these quotas in the aggregate will total \$8.8 billions, valued in U.S. currency. As part of the quota subscription each member must pay in gold the smaller of 25 per cent. of its quota, or 10 per cent. of its net official gold holdings and United States dollars. The balance of the quota payment will be made in the member's own currency.

The largest quota contributor will be the United States with \$2,750 millions; next comes the United Kingdom with \$1,300 millions; Russia with \$1,200 millions; China with \$550 millions; France with \$450 millions; India with \$400 millions; Canada with \$300 millions; and so on down the list. The assets of the Fund, therefore, will be gold, in an amount estimated at approximately \$1,640 millions[4] plus an inventory of some 44 currencies with a total value, in terms of United States dollars, of approximately \$7,160 millions.

It should be pointed out that while \$8.8 billions represents the sum of the quota contributions to the Fund, this amount cannot actually be regarded as the Fund's effective resources. For, as will become apparent in the following account, the Fund is among other things an association of borrowers and lenders, and all cannot be borrowers at the same time. For example, the United States will not want to borrow United States dollars from the Fund nor will other members want to borrow their own currencies. In the event of all the other members wanting to borrow United States dollars, the total United States dollars so available, initially at least, would be equivalent to the United States quota plus the gold holdings of all the other members—approximately \$3.7 billions in all, which would represent the real resources of the Fund for this purpose.

The *Articles of Agreement* come into force when signed by governments having 65 per cent. of the total quota subscription (\$5.7 billions), but not before May 1st, 1945 and not later than December 31st, 1945. On this basis, assent by the United States, the United Kingdom, Russia, and China, would be sufficient to bring the Agreement into effect without any other membership being required. *In theory,* the Agreement

[4]As estimated by E. A. Goldenweiser and Alice Bourneuf in an article in *Federal Reserve Bulletin*, September 1944.

could come into effect without the assent of the United States, since the quotas of the other 43 nations would total just over \$6 billions.

Par Values

Before the Fund can commence operations, it will be necessary to determine the initial par values of the member currencies. Except in cases where special arrangements are necessary, the initial par values of member currencies shall be established at the rates prevailing on the sixtieth day before the entry into force of the Agreement, which sixtieth day could be any day from March 2nd, 1945, to November 1st, 1945. Once these initial rates are determined, all trading in gold and/or exchange between members shall be on the basis of par values determined by the Fund plus or minus a prescribed trading margin.

In individual instances this basis of determination may be objected to by a member or by the Fund, in the latter case on the ground that the par value indicated could not be maintained without excessive recourse to the credit facilities of the Fund. In the event of objection by member or Fund, the Fund shall determine a period of time within which agreement on an appropriate parity must be reached. In such discussions, the Fund will have the last word, for failing agreement within this period, "the member shall be deemed to have withdrawn from the Fund on the date when the period expires".[1]

The parities when determined shall be expressed in terms of gold or in terms of the United States dollar of the weight and fineness in effect July 1st, 1944.

Members of the Fund must give a general undertaking to promote exchange stability and to avoid competitive exchange depreciation. Nevertheless, changes in the par value of a member currency may be made but only on the proposal of the member concerned, and after consultation with the Fund, and subject to the overriding provision that the pro-

[1]*Articles of Agreement.* International Monetary Fund, Article XX, Sec. 4, Par. b.

posed change is for the purpose of correcting a fundamental disequilibrium.

If a proposed change, together with all previous changes from the initial parity, whether increases or decreases,

i. does not exceed 10 per cent. of the initial parity, the Fund shall raise no objection;

ii. does not exceed a further 10 per cent., the Fund must give its decision within 72 hours if the member so requests;

iii. is not within "i" or "ii", the Fund is entitled to a longer period to make its decision.

In any event, the Fund *shall concur* in any proposed change in par value in respect of which its sanction is required, "if it is satisfied that the change is necessary to correct a fundamental disequilibrium."[1] Moreover, and to quote from the *Articles of Agreement* themselves,

> "In particular, provided it is so satisfied, it (the Fund) shall not object to a proposed change because of the domestic social or political policies of the member proposing the change."[2]

Hence, the only thing to be proven by the applicant for a change in par value is the existence of a "fundamental disequilibrium", a condition which, by the way, is nowhere defined in the Articles of Agreement.[3] If this is accepted by the Fund, then approval of the change becomes mandatory.

The Fund by majority vote, may make uniform proportionate changes in the par value of all member currencies—in other words the Fund may take uniform action to raise or lower the price of gold. Such action need not be binding on an individual member if he objects within 72 hours. Such uniform changes of par value are not taken into consideration in the formula applicable to changes in par value by individual members described in the foregoing paragraph.

Except in the case of uniform par value changes by all members, any member changing the par value of its currency

[1] *Op. Cit.* Article IV, Sec. 5, Par. f.
[2] *Ibid.*
[3] For discussion of the fundamental disequilibrium concept see page 35.

must, if the gold value is so reduced, pay into the Fund an additional amount of its currency equal to the reduction in the gold value. Conversely, if the par value of a member's currency is increased, the Fund shall make a proportionate repayment to the member in the member's currency. The principle is, of course, that the initial relative gold values of the quota subscriptions must be maintained at all times.

Accommodation Facilities Under the Agreement

Under the Agreement a member country finding itself short of some foreign currency which it needs, may, subject to specific conditions and safeguards, obtain this currency by purchasing it from the Fund and paying its own currency into the Fund in exchange therefor. If, shall we say, some South American country were temporarily short of United States dollars, instead of imposing restrictions on imports from the United States, or instead of allowing its currency to depreciate, the South American country could go to the Fund and within certain limitations obtain the United States dollars necessary to tide it over the temporary period of difficulty, paying for the accommodation by surrendering to the Fund an equivalent value of its own currency.

It will be seen that under such a procedure there is an underlying tendency for the Fund to lose currencies of countries in a continued creditor position and to have an excess of currencies of those countries in a chronic debtor position. If, for example, everybody wants United States dollars after the war, it would be possible for United States dollars to be chronically short in the inventory of the Fund. The safeguard provisions now to be described are designed to mitigate such an underlying tendency.

There are detailed and somewhat complicated regulations governing the extent to which a member country may obtain temporary accommodation and the rate at which the accommodation may be drawn down from the Fund. The basic formula safeguard is in the provision that the Fund's maximum holdings of a member's currency must not exceed 200 per cent. of such member's quota.

By way of illustration, assume that Canada enters the Fund, paying 25 per cent. of the quota subscription in gold. Our quota subscription would then be (in terms of United States dollars)

gold	$ 75,000,000
currency	225,000,000
	$300,000,000

As the Fund's operations proceeded, the requirements of other members for Canadian currency would cause the Fund's original holdings of Canadian dollars to decrease, while conversely, Canada's purchases of other currencies from the Fund would cause the Fund's holdings of Canadian currency to increase. The Fund's maximum possible holdings of Canadian currency under the terms of the formula would be $600 millions. If this limit were reached, it would mean that Canada on balance, would have obtained $375 million worth of other currencies by the payment of an equivalent amount of Canadian dollars into the Fund.[1] Not all of this accommodation could be regarded as *credit* however, inasmuch as the gold portion of the quota could presumably have been used to buy foreign currencies in any event. Hence, the ultimate *net* amount of accommodation available to Canada under the formula would be $300 millions, or 100 per cent. of the quota. In addition to the over-all limit on accommodation, it is provided that a member may not increase the Fund's holdings of its currency by more than 25 per cent. of its quota in any 12-month period except to the extent that the Fund's holdings of its currency had previously fallen below 75 per cent. of its quota.

Any of the formula limitations on accommodation may be waived by the Fund under special conditions and particularly in the case of members who have been small or infrequent users of the Fund's resources. Conversely, should the Fund be of the opinion that a member is misusing the Fund's

[1]$375,000,000 being the difference between the Fund's holdings of $600,000,000 of Canadian currency, and the original $225,000,000 of Canadian currency contributed as part of the quota.

resources, a formal report shall be presented to the member and appropriate limits may then be placed on the member's accommodation. Failing satisfactory corrective action by the member within a suitable time, he may then be declared ineligible to use any of the resources of the Fund. All accommodation from the Fund is subject to the overriding proviso that the currency required must be used for purposes generally consistent with the Agreement.

The Fund must not be used to finance any large or sustained capital outflow but may be used for capital transactions of reasonable amount for expansion of exports, or in the ordinary course of trade, banking, or other business.

Members obtaining accommodation from the Fund must pay a non-recurring service charge of ¾ of 1 per cent. on the value of the currency obtained. In addition, the average daily balances of a member's currency held by the Fund in excess of the member's quota are subject to a percentage charge on a progressive scale varying with both the size of the accommodation and the duration of the accommodation provided. These charges rise gradually to 5 per cent., after which penalty surcharges may be imposed. Once the charge for any bracket of accommodation reaches 4 per cent., both the Fund and the member must consider ways and means of reducing the Fund's holdings of the currency concerned.

Powers to Regulate or Acquire Members' Assets Held Outside the Fund

The agreement contains detailed and complex regulations aimed at relating a member's transactions in gold and convertible foreign currencies conducted outside the Fund to such member's position within the Fund. The principle is that a member should not be able to come to the Fund for extensive accommodation and at the same time independently be building up substantial foreign assets of its own. Moreover, to the extent that the member has built up such foreign assets, it will be compelled to use a portion of them to repay some of the accommodation it has received from the Fund.

Briefly, at the end of each financial year of the Fund, each member is required to use a portion of its official monetary reserves of gold and convertible currencies[1] to retire accommodation from the Fund by repurchasing part of the Fund's holdings of its currency. If, for example, the member's official monetary reserves are in excess of its quota, it is required to use such reserves to retire one half the accommodation received from the Fund during the year; and if the member's official monetary reserves have increased, during the year, one half of the increment must also be used to retire accommodation from the Fund.[2] Such repurchase shall in no case be carried to a point at which the member's monetary reserves will be less than the member's quota, or at which the Fund's holdings of the member's currency will be less than 75 per cent. of the member's quota. Moreover, the purchase provisions will be modified in order to prevent them from increasing the Fund's holdings of any other member's quota. In other words, if a part of Canada's monetary reserves are in French francs, Canada's use of French francs for repurchase of Canadian currency from the Fund must not proceed to a point where France's position with the Fund is prejudiced by an increase in the Fund's holdings of French francs above the basic 75 per cent. of France's quota.

[1]Convertible currencies being currencies and short-term government obligations (under one year) of members who are not imposing exchange control on current transactions and such other currency and short-term obligations of non-members as the Fund may deem to be within this category. (See Article XIX, par d.). Official holdings means holdings of member's Treasury, central bank, stabilization fund, or similar fiscal agency and may also mean net foreign assets of other official institutions or banks in member's territory, to the extent that such net foreign assets are substantially in excess of working balances. (See Article XIX pars. b and c.)

[2]The repurchase formula, subject to the limiting conditions noted above, is "Each member shall use in repurchases of its own currency from the Fund an amount of its monetary reserves equal in value to one half of any increase that has occurred during the year in the Fund's holdings of its currency plus one half of any increase or minus one half of any decrease that has occurred during the year in the member's monetary reserves. This rule shall not apply when a member's monetary reserves have decreased during the year by more than the Fund's holdings of its currency have increased". (Article V, Sec. 7, par. b.i.)

Exchange Control and Other Trade Restrictions

Under the Agreement, members may retain necessary exchange controls on capital transactions and indeed may be required by the Fund to impose such controls under certain circumstances. Without the approval of the Fund, however, no member shall impose restrictions on exchange payments and transfers for current international transactions.[1] Further, no member shall engage in any discriminatory currency arrangements or multiple currency practices (for example, no member may quote different rates of exchange for different purposes or to different countries) unless such practices are approved by the Fund. In principle, therefore, the Fund looks to the re-establishment of free exchange transactions between members for current purposes.

The general principles regarding the freeing of exchange control on current transactions having been stated, attention must now be given to two important exceptions.

As already indicated, the currency of a country in an extended creditor position on international account will tend to be in scarce supply in the Fund or, for that matter, outside of the Fund. When the Fund finds a "general scarcity" of a particular currency is developing (presumably a scarcity both within the Fund and elsewhere) it may issue a report analyzing the cause of the scarcity and recommending remedial measures. A member of the country whose currency is becoming scarce shall participate in the preparation of this report. Since the country whose currency is scarce is likely to be one that is continuously exporting more than it is importing, or is failing to lend abroad, or both, the remedial measures recommended might take the form of reduction of tariffs, a more active foreign investment programme, an appreciation of the exchange value of the member's currency, or even recommendations as to appropriate domestic policies designed to raise domestic incomes and prices. None of these measures, however, may be forced

[1]Payments for current transactions are specifically defined in Article XIX, par. i, to include all payments due in connection with foreign trade, normal short-term banking and credit facilities, interest and dividends, moderate amounts for amortization of loans and depreciation of direct investments, and moderate remittances for family living expenses.

upon the member country whose currency is in scarce supply.

In a further endeavour to increase the supply of the scarce currency, the Fund may attempt to borrow such currency either from the member or elsewhere; or again the Fund may *require* the member whose currency is scarce to sell its currency to the Fund for gold.

In addition to all of these measures, however, if the shortage becomes serious to the extent that the Fund's ability to supply that particular currency becomes endangered, the Fund *shall* formally declare the currency to be "scarce". Such formal declaration of scarcity empowers any member, after having consulted the Fund, to impose temporary exchange control restrictions on current transactions with the country whose currency is scarce. This is a feature that has been criticized as imposing economic sanctions against a creditor nation. On this point two comments may be made. First, it should be emphasized that the condition of scarcity is not a result of the operations of the Fund itself. On the contrary, the influence of the Fund exerted through the measures already described will tend to prevent such a scarcity from arising. Secondly, it must surely be recognized that, with or without an International Monetary Fund, if other nations cannot find, for example, enough United States or Canadian dollars, such other nations are going to limit their imports from the United States or from Canada. The Monetary Fund proposal accepts this in a spirit of practical realism, but then goes on to provide that exchange restrictions against the creditor countries shall be no more than necessary and shall be removed as soon as the necessity ceases.

It has already been pointed out that as a general rule members of the Fund will be expected to refrain from exchange control on current transactions. Nevertheless it is recognized that in the post-war transitional period a number of members of the Fund, through sheer force of circumstance, may have to maintain current exchange controls. Such members may take advantage of a special transitional arrangement which allows them to maintain controls

on current transactions for a limited period, without prejudicing their access to accommodation from the Fund. Any member using this transitional arrangement privilege undertakes to withdraw these exchange restrictions as soon as possible; and if, five years after the Fund has commenced operations and each year thereafter, a member is still controlling current transactions, he must consult with the Fund as to the future retention of these controls. Maintenance by a member of any specific or general restrictions on current transactions after the Fund has recommended their removal, may result in the member's compulsory withdrawal from the Fund.

This transitional arrangement device is obviously a means of easing the transitional period for countries such as England, whose foreign assets have become seriously depleted during the war and whose export trade has suffered, therefore making it necessary to maintain control for a time over the purposes for which scarce foreign exchange resources may be used.

The Position of Gold

There is nothing in the plan that in any way prejudices the prestige or usefulness of gold as a means of settling international balances. Gold is still the international exchange medium par excellence.

Under the agreement, a member's purchases and sales of gold must be at prices determined by the par values of the member currencies. Further, any member wishing to obtain, directly or indirectly, the currency of another member for gold, shall, provided that he can do so with equal advantage, acquire such currency by selling gold to the Fund. Any member, however, may sell gold newly produced from mines in his territory in any market.

A member may repurchase from the Fund, and the Fund shall sell for gold, any part of the Fund's holdings of such member's currency in excess of the member's quota. As already noted in the foregoing section dealing with scarce currencies, a member may be required to sell his currency to the Fund for gold.

Management and Voting

The Fund will have a Board of Governors consisting of one Governor and an Alternate appointed by each member. This Board may delegate executive powers to "Executive Directors" except such primary powers as the admission of new members, revision of quotas, changes in par value of member currencies, decision of appeals, and decision to liquidate. There will be not less than twelve Executive Directors of whom five will be appointed by the five members having the largest quotas, two by the Latin-American Republics and five by "the rest". If on the basis of these qualifications the two member countries having the largest net creditor position in the Fund are not represented on the Executive Directorate, such two countries shall be each entitled to appoint an Executive Director, thus bringing the Directorate up to a minimum of 14.

Under the voting formula, the United States would have about 28 per cent. of total voting power, the United Kingdom about 13 per cent., Russia 12 per cent., and Canada 3⅓ per cent. In addition, on any votes to increase accommodation limits, or to declare a member of the Fund ineligible to use the Fund's resources, the voting power of creditor members of the Fund is weighted upwards and the voting power of debtor members is weighted downwards. Under this arrangement the maximum vote of the United States might conceivably reach 35 per cent. of the total.

OPERATING FEATURES OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Basic Functions

The functions of the International Bank for Reconstruction and Development fall under three headings. First: the Bank may make or participate in direct loans out of its own loan fund, which loan fund will represent 20 per cent. of the total potential member subscriptions. Second: the Bank

may make or participate in direct loans out of funds which the Bank will obtain by borrowing. In other words, in performing this function, the Bank will act as a middle man, borrowing funds in one market and lending them elsewhere. Third: the Bank may guarantee in whole or in part, loans made through the ordinary channels of private international investment.

The Bank may guarantee, participate in, or make loans to any member and to any business, industrial, or agricultural enterprise within the territories of the member. All dealings with a member, or with private interests in the member's territory, shall however, be channelled through the member's treasury, central bank, stabilization fund, or other similar fiscal agency. In cases where the member country is not in itself the borrower, but where credit is being extended to some business or industry within the member's territory, the member country or its central bank, or some other acceptable governmental agency must guarantee repayment to the Bank.

Membership

All members of the Bank must be members of the International Monetary Fund. Original members shall be those who join before December 31st, 1945. Other nations, if members of the Fund, may join the Bank after that date, subject to special conditions.

Capital

The authorized capital of the Bank is $10 billions, of which the minimum required subscription of the 44 United Nations represented at Bretton Woods will account for $9.1 billions with the balance reserved for subsequent voluntary subscription by original members or for share qualification of other nations which may later become members. With a few exceptions, the required subscriptions are equivalent in amount to the quotas established under the International Monetary Fund.

Each required subscription is divided into two parts in the proportion of 20 per cent. and 80 per cent. The 20 per cent. is for the Bank's own loan fund. The 80 per cent. shall be subject to call only when required to meet losses.

The nature and manner of payment of members' liability for capital subscriptions may be illustrated by using the example of Canada's position to indicate the principles generally applicable throughout. Canada's total required subscription is $325 millions, (in terms of United States dollars of value as at July 1st, 1944). Of this amount 2 per cent. is payable in gold or United States dollars within 60 days of commencement of operations of the Bank. A further 8 per cent., payable in Canadian currency, shall be called within the first year of operation. A further 10 per cent. shall be called in Canadian currency if and when needed. That brings us up to the 20 per cent. required for the direct loan fund, or in Canada's case an amount of $65 millions. Then in addition, there is a contingent liability of 80 per cent., or $260 millions which shall be called only if, as, and when, and to the extent required to meet losses. It is important to note however, that the amount so called under the contingent or 80 per cent. portion of the subscription will be payable at the member's option either in gold, or in United States dollars, *or in the currency required to discharge the obligations of the Bank for the purpose for which the call is made.* The relative gold value of member currencies subscribed to the Bank's own loan fund is protected by provisions requiring an additional proportionate contribution from a member in the case of a significant decline in such member's currency. In the case of an appreciation of the member's currency, provision is also made for an appropriate refund.

Safeguards

The total loans and guarantees of the Bank can at no time exceed the Bank's unimpaired subscribed capital, called and uncalled, reserves and surplus. This indicates a maximum limit of loans and/or guarantees of between $9 and $10 billions, at least until reserves and surplus of any significant amount are built up.

The general restrictions and safeguards surrounding the operations of the Bank are impressive. In particular it is provided that the credit extended by the Bank by loan or guarantee must be for a specific project of reconstruction or development, and will only be forthcoming after a competent technical committee has studied and recommended the project and if the Bank is satisfied that the borrower would not otherwise be able to obtain accommodation on reasonable terms.

The Bank must make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations.[1] This reads well but might be difficult to accomplish in full without an international economic police force.

In the case of direct loans made by the Bank either from its own loan fund, or from funds borrowed by the Bank in the market for relending, the Bank's credit facilities will be only available to a borrower to provide *foreign* currencies which that borrower may need in connection with a specific project. For example, if Brazil contemplates a developmental project, it may approach the Bank for financing of its material requirements from the U.S.A. or other outside countries in connection therewith, but it will not normally be able to borrow from the Bank for expenditures for local materials and labour. This restriction may be modified under exceptional circumstances where a member country cannot raise its local currency requirements "on reasonable terms". Further, if the carrying out of a project by a member gives rise to an *indirect* increase in the need for foreign exchange by the member, the Bank may provide the borrower with an appropriate amount of foreign exchange in this connection. Such a situation might arise, for example, if a developmental project made heavy inroads on materials and labour formerly used in export industries. A consequent shrinking

[1]*Articles of Agreement*, International Bank for Reconstruction and Development, Article III, Section 5b.

of exports would thus result in an indirect increase in the member country's need for foreign exchange.

Similar conditions are not specifically set out in the case of loans guaranteed by the Bank, but such loans carry the general proviso that the Bank shall have power to determine the terms and conditions of the guarantee.

Use of the Proceeds of Loans

The Bank as such will impose no conditions that the proceeds of a loan shall be spent by the recipient in the territories of any particular member or members. However, a member's currency[1] paid into the Bank as part of such member's subscription to the direct loan fund may be loaned and re-loaned, only with the approval, in each case, of the contributing member. Moreover, such contributing member shall have the power to restrict or limit the conversion of the proceeds of the loan into any other currency. This provision therefore gives the contributing member the power to insist that a borrower spend the proceeds of a loan obtained in this manner in the contributing member's territory. In other words, loans made out of a member's own currency contributed to the Bank's direct loan fund may be "tied loans" at the option of the contributing member or members directly concerned.

In the case of loans made out of the funds borrowed by the Bank, the approval of the member in whose market the funds are raised and of the member in whose currency the loan is denominated[2] is required as a condition of the transaction. But once this approval has been given, the Bank is free to exchange the proceeds of the loan into any member currency, or currencies, necessary to meet a borrowing member's needs. In other words, loans made under this heading are not tied loans and the Bank itself has full authority over the distribution of the proceeds which may be exchanged for any currency of any other member country without restriction. To illustrate, loans under this heading might be raised in Canada, and once the Canadian Government had approved of the transaction, the borrower might spend the proceeds in the United Kingdom, in the United States, or anywhere else if the Bank approved. To keep to the example, this would mean that the United Kingdom or some other third country would come into possession of the Canadian dollar balances originally loaned to the borrower.

Similarly, in the case of guarantees, the approval of the country in whose market the funds are raised and of the country in whose currency the loan is denominated will be required. But once this approval is given, no member country may place restrictions on the distribution of the proceeds.

Repayment Features

In the case of direct loans made by the Bank (whether from its own loan fund or from sums obtained by borrowing in the market) the Bank will determine the terms and conditions of interest and amortization payments to be made to it. In cases where the Bank guarantees loans placed through the usual investment channels the Bank may exert an important influence on the terms of the loan contract through its power to determine the general conditions of the guarantee.

In cases where the Bank borrows funds and re-lends them to a member, or where the Bank guarantees loans on behalf of a borrower, the borrower shall pay an annual commission charge in addition to interest. During the first ten years of the Bank's operations this commission shall not be less than 1 per cent. and not more than 1½ per cent. per annum, on the outstanding portion of each loan. These commissions shall be paid into a special reserve fund as a first line of defence against possible losses.

In the event of default by a borrower on a loan made by the Bank out of its own loan fund, loss to the Bank would already be automatically distributed over the members in proportion to their capital subscription.

In the event of a default to the Bank, in cases where the Bank has borrowed funds in the market for re-lending to a member, or where the Bank has guaranteed the borrowings

[1]But not gold.
[2]Normally, these countries would be one and the same.

of a member, the liability of the Bank to the public would in neither case be affected. The Bank would continue to be obligated in the one instance to repay funds originally borrowed by it, or in the second instance, to implement its guarantee. But the Bank in its turn may restore its position by calling up appropriate amounts of unpaid member subscriptions.

With regard to loans made out of the Bank's own capital fund, there is an ingenious provision designed to ensure that the currency coming back to the capital fund by way of repayment will have, as far as possible, as high a relative value as it had when it was paid out. In the case of such loans it is provided that repayments of interest and amortization shall have a fixed value in terms of some currency specified by a ¾ majority vote, as they had the time when the loan was originally made. If by way of example, a loan is made and is repayable in Canadian dollars, and United States dollars are designated by vote as the "specified currency", then the subsequent interest and amortization payments in Canadian dollars must always equal the United States dollar value of the Canadian dollar payments contracted for at the time the loan was made.

With respect to the power of the Bank to enforce repayment to it of obligations incurred by members, the plan is realistically vague, stating that in cases of default "the Bank shall make such arrangements as may be feasible to adjust the obligations under the loans".[1]

Actually, in the case of *international* lending, and in the absence of international law to enforce security, no lender can do more than this, as past experience has amply proven.

The existence of a short-term credit mechanism envisaged in the International Monetary Fund proposal would presumably assist borrowers to keep up their repayment schedules in the face of a temporary shortage of the necessary foreign exchange. It is noteworthy that a member, acting within the terms of the general provisions governing accommodation from the Fund, might obtain assistance from that source to make amortization payments to the Bank.

[1] *Op. cit.* Article IV., Sec. 7, par. a.

Provision is made for relaxation and revision of conditions of repayment in the event of a member suffering from an acute exchange stringency.

If a member fails to fulfil any of its obligations to the Bank, such member may be suspended on majority vote; and the member shall then automatically relinquish its membership one year from that date unless a decision is taken by the same majority to restore it to good standing. Any government ceasing to be a member shall remain liable for its direct obligations to the Bank and for its contingent liabilities so long as any part of the loans or guarantees contracted while it was a member is still outstanding.

Management

The management structure is much the same as that of the International Monetary Fund. There will be a Board of Governors together with Executive Directors to whom the Board may delegate certain of its powers. There will also be an Advisory Council of seven members elected by the Board of Governors which would include representatives of banking, commerce, industry, labour, and agriculture.

Voting power is determined by a formula similar to that used for the International Monetary Fund. On this basis and assuming that all the 44 nations represented at Bretton Woods come in, the United States would have 31.4 per cent. of the voting power, the United Kingdom 13 per cent., Russia 12 per cent., and Canada 3.4 per cent.

DISCUSSION OF THE PROPOSALS

The Fund

The stated objectives of the International Monetary Fund —international co-operation, expansion of trade along multilateral lines, exchange stability, opportunity to correct maladjustments without recourse to measures destructive of national or international prosperity—are all surely beyond reproach. That experts representing 44 nations could meet and agree upon the specific procedures designed to approach these desirable objectives is in itself a notable event in world economic history.

Yet it must be recorded that the *Articles of Agreement* of the Fund have evoked considerable adverse comment in the United States and have also been received with not a little reserve in the United Kingdom.

In the United States, both Fund and Bank enjoy strong Treasury sponsorship. Banking opinion in that country, however, has been in the main opposed to the Fund. This opposition has crystallized in a formal report[1] issued by the American Bankers' Association and two related bodies.[2] This report, while endorsing the principle of the International Bank, rejects the concept of the Fund as impractical, "contrary to accepted credit principles" and asserts that the Fund, "in its effort to meet the situation of countries now in uncertain financial position, goes far beyond the principles heretofore accepted by the United States in recognizing and approving changes in currency values and the maintenance of exchange controls". The report does recommend, however, that the proposed International Bank for Reconstruction and Development be empowered to make loans, "under the same safeguards as the other loans of the Bank, for the purpose of aiding countries in stabilizing their currencies". Such a move, taken in conjunction with other recommendations respecting the International Bank and cognate matters,[3] would, the report claims, provide a simplified workable arrangement that "would wear better in the realities of this chaotic world".

Apparently, however, United States banking opinion is not necessarily unanimous in its rejection of the Fund proposals, since on December 11, 1944, a subcommittee of the Pennsylvania Bankers' Association recommended that Congress give both Fund and Bank proposals favourable con-

[1] *Practical International Financial Organisation*, published by American Bankers' Association, February 1st, 1945.

[2] Association of Reserve City Bankers and Bankers' Association for Foreign Trade.

[3] See page 51.

sideration.[1] There seems to be no significant body of recorded opposition to the Fund or Bank proposals representative of United States manufacturing and exporting interests. Economists, in impressive array, may be found in both the "pro" and "anti" ranks.[2]

Comment on the Fund proposals in the United Kingdom is somewhat more dispassionate in tone.[3] There has been a good deal of criticism but such criticism usually ends up by advocating modifications of the plans, and/or by stressing the necessity of action in related fields of international co-operation rather than advising outright rejection of the proposals.

[1] See *American Banker*, December 12th, 1944.

[2] For examples of U.S. comment see:

OPPOSED TO THE FUND:

National City Bank Letter, July 1944

The Guaranty Survey, (Guaranty Trust Co. of N.Y.), August 1944

"Bretton Woods Monetary Conference", J. H. Riddle, Economic Adviser, Bankers' Trust Co., *Commercial & Financial Chronicle*, July 27, 1944

"Some Aspects of American Foreign Policy", Winthrop W. Aldrich, Chairman of the Board, Chase National Bank, *Commercial & Financial Chronicle*, Sept. 21, 1944

Articles by Dr. J. H. Williams, Harvard University, in *Foreign Affairs*, July 1943, January 1944, and October 1944.

IN SUPPORT OF THE FUND:

"The International Monetary Fund—A Consideration of Certain Objections"—Edward E. Brown, President, First National Bank of Chicago (and member of U.S. official delegation to Bretton Woods Conference), *Journal of Business of the University of Chicago*, October 1944

"Bretton Woods and International Co-operation", Henry Morgenthau Jr., Secretary of the Treasury, *Foreign Affairs*, January 1945.

"The Monetary Fund—Some Criticisms Examined", H. D. White, Assistant to the Secretary of the Treasury, *Foreign Affairs*, January 1945

"Postscript on Bretton Woods", *Fortune*, September 1944.

For a most useful symposium of opinion see *International Financial Stabilization*, published by Irving Trust Co., New York, with a foreword by Murray Shields, Economist of that organization. This symposium includes articles by Alvin Hansen, Jules Bogen, Jacob Viner, Edwin W. Kemmerer, Ray B. Westerfield, and John H. Williams.

[3] For characteristic United Kingdom comment see:

The Times, Editorial August 4th, 1944

The Economist, July 29, 1944

"Bretton Woods and After", *The Statist*, July 22, 1944.

The Banker, September and October 1944, articles by Paul Einzig and the Editor

Interim Report of Federation of British Industries on Final Act of United Nations Monetary and Financial Conference, November 1944

After Bretton Woods, a pamphlet issued by P.E.P. (Political and Economic Planning), September 15th, 1944.

But the significant point of interest is that the criticisms of the Fund advanced in the United States are principally based on reasons quite different from those underlying the objections voiced in the United Kingdom. In many respects the viewpoints represent almost diametrically opposed economic concepts and philosophies.

Nowhere is this divergence of viewpoint more apparent than in discussion of the exchange rate provisions of the plan.

There is an influential body of American financial opinion which stresses exchange stability as the prime requisite of a workable international monetary organization. In its more extreme form, this school of thought seems to be looking to the gold standard as the ultimate objective of post-war stabilization measures. Against such a background of belief, the International Monetary Fund, with its rather wide powers to vary exchange rates, falls far short of the proper objectives of a stabilization plan.

In the United Kingdom, on the other hand, the gold standard is without friends. In part, the violent aversion of practically all shades of thought to a return to the metallic standard is the result of hindsight. There is a widespread conviction that the restoration of the pound to gold in April 1925 and its maintenance on the gold standard until September 1931 was mistaken and costly policy.[1] To a greater extent the prevailing attitude to the gold standard is a product of foresight—of a belief that a rigid exchange rate system would be altogether inappropriate to Britain's situation after the war. Hence, United Kingdom critics of the Fund are voicing their fears that the proposals are "too much like the gold standard" in that the exchange rate variation features are too restrictive.

As an aid to appraisal of these divergent viewpoints, it might be well to digress to consider the basic elements of difference between a gold and a non-gold standard system. The economist may skip the next half dozen paragraphs. But the layman may find them useful.

[1]Whether it was the return to gold which was costly, or the return to a rate that admittedly over-valued the pound is, of course, an arguable point.

Briefly, the gold standard, in theory and in practice, involves the necessity of keeping domestic price levels in stable relationship with a world price level through the maintenance of rigid exchange rates.[1] Under such conditions, a country has little choice of measures to correct an adverse balance of international payments. The short-term remedy must be an increase in interest rates designed to attract an inflow of capital. If short-term measures prove ineffective, the longer-term approach must be the continued use of high interest rates as a deflationary measure to force a downward adjustment of prices and costs to a point where exports will once more be at a competitive level in world markets. Further, it may be necessary to supplement and reinforce the deflationary process by limitation of imports designed to narrow the gap between receipts and payments on international account. The deflationary process is conducive to unemployment at home; and limitation of imports either induced as a result of the domestic deflation, or effected directly by specific measures, is conducive to unemployment abroad.

The end product of the gold standard then is stability of exchange rates and, be it emphasized, stability *at any cost*. If the national economy requires adjustment to keep its place in the competitive world, the necessary changes must take place in some or all of the fields of interest rates, prices, costs, and employment. But the exchange rate itself must remain inviolate.

Contrary to popular belief, the gold standard does not go very far back into history. It arose in the middle of the nineteenth century and held undisputed sway for about 60 years. For the most part this period was one of vast expansion in international commerce and investment generally within a free trade environment. The old world was still

[1]As between gold standard countries, the only exchange rate variations that could occur would be variations within the limits set by the cost of shipping gold from one country to another. If, for example, under the gold standard, the U.S. dollar were to tend to appreciate in terms of Canadian funds, the actual premium could never be more than the cost of shipping gold to the U.S.A. (equivalent to about $\frac{1}{8}$ of 1 per cent.). No one would pay any more than that for U.S. funds, since gold could move freely between the two countries and be converted into either currency at par of exchange.

developing the new. The industrialization of the new world had yet to clash with the interests of the old. Such an atmosphere was particularly favourable to an economic philosophy which saw the world pretty much as single economic area, within which the beneficent processes of trade were to go on without much attention to international boundary lines. The gold standard was a true child of the age and also an active contributor to its development and progress.

There is little wonder that after the first World War and the dislocations and inflations that followed it, nations should yearn for the return of the ordered stability of the gold standard. And yet after the return to gold did take place, led by England in 1925, it soon became all too apparent that the post-war standard was but a pale wraith of its former self. Somehow the spirit of life had departed from it; and on September 21, 1931, England abandoned gold and this was the forerunner of similar action to be taken sooner or later in the course of the ensuing five years by every former gold standard country in the world.

The limits of this pamphlet will not permit even the briefest analysis of the specific causes of the breakdown, but one underlying principle may be suggested that is fundamental to the discussion which follows. The basic distinction between the world after 1918 and the world before 1914 was the progressive decline of internationalism within the post-1918 period. More and more after World War I did economic policies and processes tend to become national in their objectives. As related to the gold standard, this meant that decisions and actions with respect to monetary policy were more and more determined by purely domestic considerations. More and more did monetary authorities find themselves taking action to *prevent* gold movements from having their traditional effects on interest rates, prices, and business activity. The impact of political and social thought made it progressively difficult to initiate or to justify action in the interests of a stable exchange rate if such action raised the possibility of deflation and unemployment at home or the creation of a competitive threat to established domestic

industries. Under such conditions there was no longer the assurance of the self-compensating element so necessary to the working of the gold standard. And with this feature gone, or at best working badly, deflation initiated in any one country tended to become cumulative and contagious. Under these circumstances, *exchange stability all too often could only be achieved at the cost of extreme instability of the national economy.*

This highly compressed review of the basic workings and history of the gold standard has been resorted to solely to point a contrast. Whereas under the gold standard the orthodox objective of monetary policy was stability of exchange rates, few today would question that the objective of monetary policy is now "full employment". And because the objective is full employment and because governments have accepted responsibility for it, few governments would dare to allow external forces transmitted through a rigid exchange rate to bring about automatically a condition of deflation. Moreover from the standpoint of governments, there are today grave fiscal difficulties in the way of using an increase in the rate of interest as a monetary corrective. Cheap money is an article of the full employment creed and is therefore sacrosanct on this ground, apart entirely from its desirability in the face of mounting public debts. Here then we have the basis of an economic philosophy which accepts the necessity and the desirability of variations of exchange rates, if the alternative of maintaining the exchange rate rigid would prejudice internal economic stability. Lord Keynes, in a recent statement before the House of Lords in discussion of the "Experts Plan" of April 1944 (which was very close to the present International Monetary Fund) set forth very clearly the articles of belief of the "new orthodoxy".[1]

> "We are determined that in future, the external value of sterling shall conform to its internal value as set by our own domestic policies and not the other way round.

[1]Address delivered on May 23, 1944. A verbatim report is available in the *Commercial & Financial Chronicle*, June 22nd.

"Secondly, we intend to retain control of our domestic rate of interest so that we can keep it as low as suits our own purposes without interference from the ebb and flow of international capital movement or flights of hot money.

"Thirdly, whilst we intend to prevent inflation at home, we will not accept deflation at the dictate of influences from outside.

"In other words, we abjure the instruments of bank rate and credit contraction operating through the increase of unemployment as a means of forcing our domestic economy into line with external factors."

Then, relating these principles to the currency proposals, he goes on to say, in reply to those who fear that the limitations on exchange variation involved in the currency plan are too rigid, and therefore prejudicial to the United Kingdom's desire to pursue a flexible exchange rate policy:

"For instead of maintaining the principle that the internal value of a national currency should conform to a prescribed *de jure* external value, it provides that its external value should be altered if necessary, so as to conform to whatever *de facto* internal value results from domestic policies which themselves shall be immune from criticism by the Fund. Indeed, it is made the duty of the Fund to approve changes which will have this effect. That is why I say that these proposals are the exact opposite of the gold standard. They lay down by international agreement the essence of the new doctrine far removed from the old orthodoxy."

It is little wonder, therefore, that the Keynesian interpretation of the currency plan with respect to the variation of exchange rates will arouse serious misgivings among those who believe that exchange stability will be productive of long-run benefits that will outweigh, in terms of volume of international trade, the facile attractions of fluctuating exchange rates.

Mr. Winthrop Aldrich's speech, (referred to in the footnote on page 29) epitomizes these misgivings in the following statement:

"The provisions of the plan permitting changes in exchange rates are so liberal that exchange depreciation would undoubtedly become an accepted and normal procedure in international financial affairs. Nations could employ exchange depreciation as a substitute for internal fiscal reform and for internal adjustment of costs and prices. Proposals for exchange depreciation from one nation would be quickly followed by similar proposals from others. All proposals could be made in the name of disequilibrium to which the Fund and the member nations would doubtless give an elastic definition."

Those who fear that, far from promoting exchange stability, the Fund is more likely to become an association for the depreciation of exchange rates, can point to a vagueness in the plan itself in support of their contention. The Fund *must* approve an application for a variation in the exchange rate if the applicant nation can prove the existence of a "fundamental disequilibrium". So far all is clear cut. But nowhere in the *Articles of Agreement* is a "fundamental disequilibrium" defined.

Already the fundamental disequilibrium concept is providing a nice point for discussion by economists.[1] The gist of such discussion to date would indicate general agreement with the thesis that a country's exchange situation is in fundamental disequilibrium if its exchange rate is either over or under valued, thus subjecting the national economy to deflationary or inflationary influences from the outside world.

To use a hypothetical illustration, purposely stated in exaggerated form: If we were to go into the post-war years with the pound sterling valued at say $4.00 U.S., but if the level of prices and costs in England were such that the pound could, in fact, buy only $3.00 worth of goods and services entering into international trade, then the pound would be over-valued; a fundamental disequilibrium would exist to the great disadvantage of England's export trade. Under the terms of the Agreement, an appropriate adjustment in the value of the pound sterling would become mandatory, at England's request.

[1]See *The Review of Economic Statistics,* November 1944, "Currency Depreciation and the International Monetary Fund", Gottfried Haberler; "A Brief Note on Fundamental Disequilibrium", Alvin Hansen; and "Some Comments on Professor Hansen's Note", Gottfried Haberler.

In making this adjustment, however, care would have to be taken not to create a disequilibrium in the other direction, i.e. not to put sterling at so low a value in terms of the United States dollar that to use an extreme example again, one might pay $2.00 in the exchange market for a pound and then buy $3.00 worth of goods and services with it in London. It is this latter process, the giving of the currency unit an artificially low value in the exchange market, that is the essence of the competitive currency depreciation which members of the Fund undertake to abjure.

The management of the Fund will have the difficult task of determining whether a disequilibrium is really fundamental and therefore likely to persist. Presumably too, the management will have to distinguish between a deficit in a balance of international payments that is due to an exchange rate discrepancy and one due to depressed conditions in foreign markets. The management will also have to decide whether depressed conditions in any one country are due to an overvalued exchange rate, or rather to an unbalanced or inefficient domestic economy. Moreover, the management will not be able to approach these difficult problems with the leisure so often essential to economic analysis. If a member comes along with a request for permission to depreciate his currency by not more than 20 per cent. in relation to the initial parity, the Fund may be compelled to give its decision in 72 hours!

Further, it is noteworthy that the exchange variation provisions of the Fund seem to have been set up on the assumption that no member is ever likely to request that his exchange rate be *raised*. It is conceivable that as a result of a marked increase in technical efficiency, a member country's production costs may get down to the point where the exchange rate may become undervalued; and where the country concerned is in effect enjoying the benefits of competitive devaluation. But since, under the terms of the Agreement, a change in the par value of a member's currency may be made *only on the proposal of the member concerned,* there seems to be no direct means whereby the Fund on its own initiative could compel a member to bring about the

necessary upward revaluation of its currency in order to restore equilibrium with the rest of the world. Indirect pressure in this direction could of course be applied; and if the country concerned got into an extended creditor position to the point where its currency would formally be declared "scarce", the pressures could become very direct indeed.

Enough has been said to this point, to make it clear that the Monetary Fund proposals, with respect to variation of exchange rates, are a frank compromise between the two extremes of complete rigidity and complete flexibility of exchange rates.

Certain supporters of the Fund, on both sides of the Atlantic, have obviously been endeavouring to "soft pedal" the compromise nature of the exchange rate provisions of the plan. The Fund's proponents in the United Kingdom tend to play up the latitude for exchange variation which the plan allows. In the United States the Fund's advocates are much more inclined to stress the exchange *stabilization* aspects of the plan. In the writer's view, nothing but harm can come from an ostrich-like effort to ignore that sharply divergent economic ideologies exist, and that the Fund's exchange rate provisions represent a compromise between them. Nor is any apology necessary for the compromise position taken. For the real question is not a choice of theoretical ideals, but whether the Fund in its actual operation is likely to be productive of a better combination of exchange stability and stability of national economies, than can come about through such alternative means as are a *practical* possibility.

Talking in practical terms, and keeping within the foreseeable future, the gold standard must be ruled out as an alternative. This statement is not primarily based upon considerations respecting the distribution of gold. It is quite true that many countries' monetary reserves of gold and United States dollars are today higher than they have been for years. As nearly as can be estimated, gold and United States dollar reserves of countries other than the United States amounted to about $17 billions at the end of September 1944 as compared with between $7 and $8 billions in 1928.[1] Between January 1941 and September 1944, the increase in the gold reserves of countries other than the United States was about \$5½ billions, of which about \$1¼ billions represented gold outflow from the United States with the balance being accounted for by new production. But this \$5½ billion increase in the "outside world's"[2] gold holdings is only equivalent to the loss of gold holdings which these countries experienced over the preceding six years between February 1934 and December 1940.

It is quite true however, that some of the Latin-American Republics and possibly a few of the liberated countries of Europe, might now have sufficient gold reserves to make a return to the gold standard possible. But the United Kingdom and many other countries almost certainly have not. It seems hardly realistic to expect that countries whose gold stocks are now depleted will be content in the immediate post-war years to borrow or to export goods and services in order to pay for a gold reserve instead of for imports that will be badly needed. But apart entirely from the matter of the distribution of gold, the primary reason for ruling out the gold standard as a practical form of world monetary organization is that very few countries in the world would be willing to accept the discipline over their national economies that rigid adherence to the gold standard would involve.

But if the gold standard must be dismissed as a practical near-term possibility, the extreme philosophy of complete independence of domestic monetary action, with the exchange rate being left free to fluctuate where it may, is no less unreal. No country can safely let its domestic level of prices and costs rise while trusting to a declining exchange rate to keep its exports reasonably priced in the outside world. Such a process has its dislocations no less than deflation. Not the least of these is the effect on the internal economy of the automatic increase in the price of imports that the declining exchange rate brings about. For example, the effects upon Canada by way of increased costs of essential raw materials, and the increased burden of debt payments and other transfers, set definite limits beyond which we would not see our dollar decline in terms of United States funds without taking at least some corrective domestic measures. Moreover, freely fluctuating exchange rates introduce a serious element of risk into international trade and as pre-war experience has amply proven, invite destructive retaliatory tactics. We have learned enough from international currency experience between 1931 and 1939 to suspect that unlimited freedom to vary exchange rates can mean a progressive curtailment of world trade. Actually, few countries seem to desire a floating exchange rate for long; and indeed much of the monetary management between 1931 and 1939 was in the direction of minimizing exchange fluctuations and directly controlling the exchange value of the currency, if not in relation to gold, in relation to certain key currencies around which the minor units clustered.

[1]See *Federal Reserve Bulletin*, November 1944
[2]Countries other than the United States.

The practical alternatives to the International Monetary Fund proposals are therefore, not the pure exchange stability or the pure exchange flexibility of the theorists. Realism compels the conclusion that, failing some workable form of truly international monetary organization, the alternative will be efforts to achieve partial and piecemeal stabilization through bilateral trade devices and/or the formation of currency blocs. The essence of the bilateral technique is that each country within the arrangement is able to impose the specific conditions under which it will accept imports from some other country and pay for them. In effect, under the bilateral system, one country may say to another, "we will buy from you but only to the extent that you will buy from us". Currencies are not mutually interchangeable anywhere in the world; and trade is restricted either within the narrow channels of bilateral agreements, or within the areas defined by currency blocs.

Under the multilateral approach, which is the aim of the International Monetary Fund, there is not the same necessity for any two countries to attempt to equate their imports and exports. Within a multilateral area, a creditor country can take payment by importing goods or services from *any* or all of the countries within the group. A debtor country can balance its accounts by exporting goods or services or borrowing, anywhere within the multilateral system. It might be mentioned here in passing, to return to it later, that no country in the world has a greater interest in the restoration of such a system of trade and exchange than has Canada.

The danger of a post-war world split up into currency blocs, with consequent restriction of transactions as between one bloc and another is very real. It is of the utmost significance that there is a growing tendency in England to look with increasing favour at the idea of a sterling bloc. According to this view the United Kingdom, faced with a problem of heroic dimensions in the restoration of her export trade, will need to retain the utmost scope for independent action in the international sphere. And whatever may be the attractions of multilateral trade as an ideal, sheer economic necessity may compel the United Kingdom to develop a sterling trade and currency area. It is argued therefore, that the risk to the United Kingdom in accepting membership in the International Monetary Fund would be very great indeed; because in so doing the United Kingdom would be seriously limiting its freedom to vary its exchange rate, to form a sterling bloc, or to make special exchange arrangements with specific countries. Further, it is urged that the consequent risk involved in accepting the limitations on the Monetary Fund proposals, would be enhanced immeasurably if the domestic economy of the United States is going to be subject in future to the same violent fluctuations as it has been in the past, with consequent repercussions on the United States' position as an importer of goods and as an exporter of capital.

Considerations such as these have prompted *The Times* (London)[1] to ask "whether the scheme (the International Monetary Fund) makes adequate provision for the protective action which may have to be taken by any country that attempts to maintain a high national income and level of employment in the face of deflationary developments abroad?" The power to impose exchange control on current

[1]August 4th, 1944

transactions is seen as one of these protective measures as well as "the long term planning of overseas trade"; and these, points out *The Times*, are measures "to which the Bretton Woods plan seeks to offer an alternative, but is the alternative adequate." Further, *The Times* suggests that "it is an economic necessity to offer to smaller nations opportunity and encouragement to combine into economic groups such as the sterling area" and asserts that "the Bretton Woods scheme will require careful scrutiny on this head".

Actually, once the privileges of the "transitional arrangement" could no longer be invoked, a sterling bloc or any other currency bloc would be inconsistent with the principles of the Monetary Fund, if membership in such bloc involved discriminatory exchange rates or current exchange control devices against other members of the Fund.

Regarding the risk of acceptance, *The Economist* is even more outspoken than *The Times*. The following quotation from *The Economist* of July 29th 1944, which while lengthy, it would be a pity to paraphrase, is highly significant:

> "The essential difference between the American and British positions is that there is virtually no risk for the United States in ratification. Let us suppose that the worst happens, and that the post-war world is not one of balance and expansion, but of distortion and depression, America risks, indeed, the loss of a sum in dollars and gold equal to the cost of carrying on the war for ten days—and 'loss' means, of course, that this sum will have been spent in the United States by other countries. But all the other provisions of the Fund would, in such circumstances, be more in America's interest than in any other country's. As in the depression of the 1930's the American interest would be to prevent other countries from imposing exchange controls (which the strong dollar would not require), from depreciating their currencies, and from discriminating against purchase of American goods because they were shorter of dollars than of other currencies. The closer the approach to the gold standard—which, in these days, is a dollar standard—the better American interests are served, in prosperity and depression.
>
> "But Britain is in different case. Even in deepest crisis, Schachtism will never pay this country. But it

is in the British interest to be free to make the best of a bad job if a bad job is what has to be faced. And the circumstances of the United Kingdom dictate other methods of making the best of a bad job from the American. If the circumstances of 1931 were to recur, Britain would wish to be able to allow the pound sterling to find its level and to concert measures for stabilizing trade within a group to which all countries that would abide by the rules should have access. A Bretton Woods system would not be in the British interest in times of crisis."

The situation, as *The Economist* sees it, poses a dilemma for the United Kingdom. To reject the Bretton Woods documents would be "to surrender once and for all the chances of realizing the hopes on which they are founded". And yet to accept the proposals may be "a dangerous tying of hands if the hopes are not realized". The answer according to *The Economist* is to accept (but not necessarily without conditions) the Bretton Woods proposals while pressing to obtain international agreements on trade and commercial policy "that will build up the assurance of a reasonable world economy". This is substantially the same ground taken by the Federation of British Industries in its interim report on the Bretton Woods proposals issued in November 1944. In this report the Federation endorses the general principles of the Fund and the Bank but proposes that a clause should be inserted in the *Articles of Agreement* of the Monetary Fund, to provide for a reviewing conference to be held at a suitable date towards the end of the transitional arrangement. Such a conference would review the operations of the Fund since inception and would be empowered to recommend extension of the transitional period if such course should appear necessary. The Federation also suggests that the United Kingdom Government should make it clear from the outset that its attitude to its own relations with the Fund, at the time of the reviewing period, should be influenced by the progress made up to that time in related fields of reduction of trade barriers, and international collaboration on measures designed to maintain high levels of employment and rising living standards.

An attempt has been made to suggest a practical alternative to the International Monetary Fund organization, through what has come to be known as the key currency approach. The key currency thesis was originally advanced by Dr. John H. Williams of Harvard University;[1] and has since been expanded somewhat by other commentators.[2] As a composite statement of the key currency view, it would be fair to say that its advocates claim that the Fund proposals are unnecessarily complex and, above all, unrealistic in that they are unduly preoccupied with symptoms rather than with more fundamental underlying factors which alone can ensure satisfactory exchange relationships.

According to the key currency school of thought, post-war monetary stabilization to be successful, should be a piecemeal and gradual process. Stabilization should start as between the pound sterling and the United States dollar, with appropriate mutual credit arrangements between the two countries designed to support the stabilized rate in time of stress.

The initial key currency thesis has been supplemented by suggestions that England be provided with a grant-in-aid from the United States sufficiently large to establish stability between the dollar and the pound. Other proposals are that the whole matter of exchange stabilization be made conditional upon prior agreements between the United States and the United Kingdom and other members of the British Commonwealth on such subjects as tariff barriers, Imperial preferences, export subsidies and other commercial and currency arrangements. When satisfactory agreements are reached in these fields, then let the dollar and pound be stabilized. Once this is accomplished then let attention be given to the stabilization of other currencies. Throughout all, let it be kept in mind that "true exchange stability presupposes the absence of internal inflation and the existence of freely competitive forces. Budgets must be balanced, commercial systems divorced from deficit financing, floating

[1]See articles by J. H. Williams in *Foreign Affairs* of July 1943, January 1944 and October 1944.

[2]See Winthrop W. Aldrich, *Op. cit.*

debts refunded, interest rates unpegged, and price and rationing controls removed."[1]

The important contribution of this viewpoint is its insistence that satisfactory exchange relationships, if they are to maintain for any length of time, must reflect satisfactory relationships in cognate fields. The points of difference between the advocates of the key currency approach and the proponents of the Bretton Woods form of organization, centre in part around practical matters of timing. Those urging the adoption of the Fund proposals maintain that the world will not wait for the rather deliberate step by step approach implicit in the key currency plan.

For example, it may be asked whether it is realistic to assume that a satisfactory agreement on tariff reduction and trade policies (even when the conferees are limited to the British Commonwealth and the United States) could be reached with any reasonable degree of speed. After all, the Monetary Fund proposals are more or less impersonal. Within any one country no specific interest is prejudiced. But in the case of tariffs, the clash of divergent domestic interests would render the problem much more difficult to solve both from a political and economic standpoint. This is certainly not to say that enlightened tariff policies are matters of little moment in post-war reconstruction. Quite the contrary.[2] But the practical question is whether it would be the part of realism to jettison what has already been accomplished in the way of international agreement on the principles of purely monetary organization, and to start out all over again in a direction where agreement may be much more difficult to reach. Doubts as to the practical wisdom of making agreement on trade and tariff policy a *pre-condition* of currency stabilization are increased upon reflection that *until currency stabilization is achieved, agreement on tariffs would have little effect, since a tariff reduction made today could be undone tomorrow by a policy of currency depreciation.*

[1]Winthrop W. Aldrich, *Op. cit.*
[2]It might be re-emphasized here that the *Final Act* of the Bretton Woods Conference included a subsidiary resolution recommending agreement on reduction of obstacles to international trade at the earliest opportunity.

If in addition to agreements on tariff and trade policy, there are added to the prerequisites of exchange stability the items of domestic economic reconstruction and balanced national budgets, then the practical value of a piecemeal stabilization, as an alternative to the International Monetary Fund approach, is even more diminished. For to wait for the achievement of these prior objectives, would not only postpone for many years the achievement of currency stabilization itself, but would also postpone the attainment of the prior objectives as well.

The key currency proposals also are open to question on other grounds. Enough has been said and quoted in this article to indicate the emphasis in the United Kingdom on the necessity of the greatest possible freedom of action in post-war monetary and trading policies. Does it appear really likely that the United Kingdom would consent to tie the pound to the dollar *before* stabilization agreements were concluded with other countries? If participation in an international scheme under conditions of considerable flexibility is viewed in England as a rather risky surrender of independence of action, how much greater would be the opposition to stabilization with the dollar on a bilateral basis?

Still other considerations arise, which cannot be adequately explored within the confines of this pamphlet. Just to mention them—what would happen to other currencies pending the stabilization of the pound and United States dollar? What arrangements, if any, would be made for the conversion by third countries, of sterling balances into United States dollars or vice versa? (As will be indicated on page 54 following, this is a question of tremendous significance to Canada.) Finally, is the concept of the "key currency" really valid for the purposes of a workable post-war exchange mechanism? In the light of their relationship to important commodities in world trade, the currencies of many relatively small countries are still of considerable importance. As Louis Rasminsky has put it:

> "No one would claim that the Canadian dollar is a 'key currency' in any general sense. But so far as the American wheat states are concerned, the Canadian

dollar is in fact a key currency and so is the Argentine peso and so is the Australian pound. . . . Examples may be repeated at will: so far as bacon producers are concerned the New Zealand pound and the Danish crown are key currencies; so far as newsprint producers are concerned the Canadian dollar and the Swedish crown are key currencies. What, in the light of this, are the real prospects of monetary stabilization arrangements which are confined to the Great Powers?"[1]

Inevitably, multilateral considerations break into the key currency scheme.

Another focal point of discussion and argument centres around the manner in which credit accommodation is provided by the Fund. An influential body of opinion in the United States, while admitting freely that short-term international credit will be necessary for the reconstruction of a functioning system of international trade, raises the question whether the procedure offered by the Fund is a satisfactory and workable approach. There is considerable opposition to the fundamental feature of the plan which gives a creditor automatic access to the resources of the Fund as a matter of right. It is therefore urged that extension of credit should be on a less impersonal basis and should be accompanied by some power on the part of the creditor to stipulate the purpose of use of the credit by the recipient. The American Bankers' Association report already referred to, expresses this viewpoint in the following terms:

"As opposed to the usual lending practice, which places the responsibility for making out a case for credit upon the borrower, the Fund goes on the theory that the borrower is entitled to credit unless the lender can make out a case to the contrary. And under the Bretton Woods plan the lender is an institution in which the United States would have only a minority vote as compared with actual and potential borrowers."

In reply, supporters of the Fund maintain that from the standpoint of the restoration of a functioning system of international trade, there is a definite advantage in providing member nations with a known and agreed upon line of

[1]Article in *Foreign Affairs*, July 1944, *Op. cit.*

short-term credit in advance. Such a view is clearly reflected in one of the clauses of the preamble to the *Articles of Agreement* which lists, as one of the purposes of the Fund, "*to give confidence* to members by making the Fund's resources available to them under adequate safeguards . . ." This viewpoint is reinforced by the consideration that as a counterpart to a line of credit, known and agreed upon in advance, members of the Fund would be making certain very definite advance commitments with respect to consultation with the Fund on changes in exchange rates and convertibility of their currencies after the transitional period. It is not likely that countries would be willing to make these commitments without foreknowledge of the manner in which and the extent to which the Fund will stand behind them should need arise.

Then too, it may be urged that the limitations on the amount of credit forthcoming to any member, plus the limitations on the rate at which this accommodation can be used, plus the rather heavy charges on the accommodation itself, plus the provision for repayment out of assets independently acquired, plus the pressures that the Fund may apply in the event of misuse, should, on balance, be sufficient to discourage any widespread use of the Fund's resources for any purpose other than temporary accommodation. To this, it may be replied that nearly all the safeguarding provisions of the International Monetary Fund may be varied in one way or another. What real guarantee is there that political pressures will not be used to distort and even to nullify the mechanism of safeguards set up in the Plan? To this the only possible answer is that each nation, from the standpoint of its own intelligent self-interest, will have to assess the probable gains and losses accruing from the venture in faith which the formation of the International Monetary Fund would involve. For each country, "loss" of its quota would mean that the country in question would have contributed goods and services to some other country or countries without receiving in return an equivalent amount of goods and/or services or gold. It is a risk always to be faced by a country with a so-called "favourable" trade balance. Such a risk will not of course disappear if the International Monetary Fund fails to come into being. On the contrary, the risk is likely to increase; for in a less than multilateral trading system, the ever present problem of the creditor country—i.e. how to make it possible for other countries to pay their indebtedness—becomes more difficult to solve.

In summary, it is apparent that the techniques of the International Monetary Fund are essentially the techniques of compromise in pursuit of a *limited* objective. The Fund is seen as simply *one* of the steps to be taken as part of a broad programme requiring action on many fronts. For example, the *Articles of Agreement* in themselves have nothing to say about tariff policies, or domestic measures designed to promote full employment. In the monetary field, the Fund's proposals provide no formula for dealing with the vexed problem of wartime accumulations of blocked exchange balances. For the future, the Fund's mechanism offers at best but a partial measure of exchange stability and a partial freedom from exchange controls. Extremists of both camps, those who look to complete exchange stability as a *sine qua non* of post-war international monetary organization, and those to whom flexibility is paramount, will find much to criticize. But surely realism compels the conclusion that any form of monetary organization having the remotest hope of survival must provide adequate scope for compromise. Is it not better to endeavour to bring divergent ideologies into working relationships within the confines of a broad and flexible organization, than to set them at loggerheads outside it?

Moreover, one cannot escape the conclusion that the practical alternative to the Fund proposal, namely the key currency approach in its various manifestations (of which the American Bankers' Association proposals for piecemeal stabilization measures through the International Bank is one) leaves much to be desired. For one thing, to the extent that currency stabilization is seen as a step to be taken only after achievement of widespread tariff reduction and/or internal budgetary equilibrium, the approach seems unneces-

sarily ambitious and risky. To attempt to attain the most difficult objectives first, may result in missing all of them. Secondly, in so far as the exchange stabilization measures proposed are essentially bilateral in concept, it may be suggested that the key currency approach is not ambitious enough. A series of isolated stabilization agreements that would take rather a long time to achieve would be a poor substitute for a multilateral working agreement on orderly exchange relationships which could go into practical effect *speedily* upon conclusion of hostilities. The time element is of importance in the matter. For if some exchange mechanism, imperfect as it may be, is not quickly forthcoming to serve the needs of the transition period, the alternatives are likely to be restrictive practices of bilateralism that may determine the course and conditions of world trade for a generation.

The Bank

Turning now to the proposed International Bank for Reconstruction and Development, one finds that this proposed institution has attracted a very considerable body of public support. Many, indeed most, of those who for various reasons have opposed the International Monetary Fund, are in favour of the Bank.[1]

One reason for the relatively hospitable reception accorded the Bank is, of course, that it is not unconventional in concept. The Bank procedure does not make credit facilities available automatically, but only for a specific purpose, after due investigation of circumstances involved and after imposition of all reasonable safeguards. This is not to suggest that the procedure envisaged for the Bank, which is a long-term lending device, should have been applied to the Monetary Fund which is essentially a short-term credit mechanism. But the very fact that the International Bank *is* "more like a bank" does add considerably to its chances of acceptance, particularly in the United States.

[1]See Dr. John H. Williams, "International Monetary Plans" in *Foreign Affairs*, October 1944.

In one or two quarters there have been some questions raised as to the size of the proposed institution. It has been suggested that a $10 billion institution to handle loans that the ordinary channels of private investment will not touch, is unnecessarily large. Back of this viewpoint lies the fear that the very size of the Bank's resources may be conducive to a repetition of the unsatisfactory lending of the 1920's when the record of foreign lending was conspicuously bad—when foreign risks were often badly chosen and when the proceeds of loans were on many occasions used by the borrowers for uneconomic purposes.

In reply, it may be pointed out in the first place that the Bank will only become a $10 billion institution if an actual need is shown to exist for international financing of a type that will measure up to the Bank's requirements and standards. It may be noted however that the $10 billion lending limit proposed for the Bank compares with an actual outflow of long-term capital from the United States of approximately $11¼ billions during the years 1920 to 1929 inclusive.[1] Further, in relation to long-term capital needs for development of areas in which existing capital equipment is pitifully inadequate and consumption standards inordinately low, the potential resources of the Bank do not appear overly large. One United States planning organization has recently estimated that the world's total capital needs for reconstruction and continuance of normal developments will be somewhere between $150/200 billions in the first post-war decade.[2] Then too, it will be recalled that the proposals for the new institution explicitly provide that if any country has adequate labour and material to do its own capital development, there is no excuse for coming to the Bank.

A second point raised with respect to the Bank is that, granted that post-war lending on a large scale will be necessary, the world's creditor countries should do the job themselves, as individual nations, and under terms and conditions which they themselves impose. Since the principal

[1]*The United States in the World Economy,* U.S. Department of Commerce.
[2]National Planning Association, *America's New Opportunities in World Trade,* Planning Pamphlets No. 37-38.

creditor and exporter of capital in the immediate post-war years will obviously be the United States, the proposal boils down to the proposition that the United States should do its own lending. It is noteworthy that the American Bankers' Association, while approving the Bank, with some modifications, recommends an expansion of the capital funds of the Export-Import Bank to $2 billions,[1] "first, to provide means for meeting promptly deserving credit needs prior to the setting up of an international bank, and second to enable the United States to make loans in which this country has special interest and which can be made more effectively through a national institution than through an international body". In this connection, of course, the reply can be made that there is nothing whatever in the Bank proposals that would limit the United States or any other country in lending independently when, where, and in any amount that it likes. If such independent lending is in fact adequate to meet the demand for capital for the financing of projects that should be undertaken in the interests of debtor and creditor countries alike, then there will in fact prove to be no need for the proposed International Bank. But the sponsors of the Bank are proceeding on the rather more realistic assumption that the obvious risks in foreign lending will be so great in many instances, as to discourage and deter either individual governments or investment interests within individual countries, from making loans to specific borrowers without the pooling of risks that the International Bank mechanism involves.

Finally, and with respect to both the Fund and the Bank it is perhaps appropriate that discussion should end on a question, and one which points to the major difficulty that these plans and others in related areas of international organization may have to face. How can there be established within the international order a semi-legalistic procedure without sanctions for enforcement? For the procedural clauses of a currency plan or an international bank cannot in the nature of things be in themselves an adequate guar-

[1]At the present time the authorized and outstanding capital funds of the Export-Import Bank are $175,000,000. Total Assets as at December 31st 1944 were $263,596,016.

antee of successful operation. The moral responsibilities devolving upon management and upon members will be tremendous. There will be great need for a standard of international conduct founded upon at least some capacity for national self-discipline in the interests of a fuller measure of prosperity than can be obtained through economics and philosophies of narrow monetary nationalism. This is a lot to ask, but only in such an atmosphere can plans for a brave new world, no matter how ingeniously contrived, come into practical effect.

CANADA IN RELATION TO THE PROPOSALS

For a country so dependent on post-war international trade as is Canada, there has been remarkably little public discussion of the Bretton Woods proposals.

At the administrative level the Canadian Government is rather definitely on record in favour of international currency organization along "Bretton Woods" lines. The Minister of Finance and his Deputy have both made addresses in the United States favouring the Fund approach and pointing out the difficulties and disadvantages of the key currency alternative.[1]

The Governor of the Bank of Canada in his Annual Address delivered on February 10th, 1944, referred to the British, American, and Canadian currency plans then extant, pointing out that:

> "No doubt these plans represent something less than perfection, and criticism should be welcomed. In the last analysis, however, they must be assessed against the practical alternatives which are either:
> (a) no plans for the provision of external credit at all, or
> (b) plans for the extension of trade credit directly between individual countries on a bilateral basis.
>
> "It would be unrealistic to assume that bilateral credit would not sooner or later be accompanied by trade

[1]The Minister, before the New York Academy of Political Science on November 10, 1943;
The Deputy Minister, before the Institute of Post-War Reconstruction, New York University on December 15, 1943.

> discrimination in favour of the countries extending credit. In the long run this would hamper world trade almost as much as the absence of international credit, and would be even more likely to promote economic imperialism and international discord."

The Alternate Chairman of the Foreign Exchange Control Board has written a widely quoted article in support of the Monetary Fund concepts in the United States journal *Foreign Affairs*.[1]

No adverse comment on either Bank or Fund has been forthcoming from Canadian banking institutions. On the contrary, high ranking officials of some of the banks, in the course of annual addresses, have publicly endorsed the principles underlying the proposals.[2]

There is no doubt whatever that the objectives of the Fund and Bank proposals—the stimulation of international trade and investment, are altogether in harmony with Canada's interests. The connection between Canada's domestic level of income and employment and external trade requires no elaboration here. Canadian interest in a *multilateral* system of trade, great as it was before the war because of our peculiar relationship with both the sterling and the United States dollar areas, has been enhanced by the developments of the war and the significance of these developments for the future.

Canada will end the war a creditor nation as far as over-all international transactions on current account are concerned. Indeed, Canada was in such a position for about five years preceding the war. But the chances are that in the post-war period, we shall continue to have a considerable credit balance in our trade with the sterling area while running a moderate debit in our transactions with the United States, unless our trade is forcibly and painfully

[1]Louis Rasminsky "International Credit and Currency Plans", *Foreign Affairs*, **July, 1944.**
[2]See Annual addresses of:
George W. Spinney, President, Bank of Montreal, Dec. 4, 1944,
Morris W. Wilson, President, Royal Bank of Canada, Jan. 11, 1944,
R. S. Waldie, President, Imperial Bank of Canada, Nov. 22, 1944,
and also, on the forerunner plans:
J. A. McLeod, President, Bank of Nova Scotia, Dec. 31, 1943.

fitted into bilateral channels. Hence, our interest in the restoration of free convertibility as between sterling and the United States dollar will be immense; and to the extent that such restoration were hastened by the inception and operation of a currency plan, Canada's ends would be well served.

True, even if the International Monetary Fund were in operation, England would almost certainly make use of the privileges of the transitional arrangement. Under such circumstances sterling might not be freely convertible into United States dollars for several years, leaving Canada in the awkward position of having to finance at home a part of her exports to the sterling area. But membership in the Fund, in the meantime, could be a very real assistance with regard to our situation *vis à vis* the United States. Without the privileges of the Fund, our choice of measures to meet any sudden and considerable deficit in our international transactions with the United States is limited to exchange control or currency depreciation. Neither of these alternatives is without its disagreeable implications for Canada. But with the privileges of the Fund at Canada's disposal, this country's range of choice is widened. Under the transitional arrangement we could still have exchange control on current transactions if we wanted it and probably for as long a time as England was enjoying the same privilege. We could have an exchange depreciation of 10 per cent. from our initial parity on entering the Fund without anyone saying us nay; and we could have an even greater degree of depreciation if we could make out an adequate case. But in addition, we could from time to time use our accommodation privileges under the Fund to mitigate the undesirable consequences of these other alternatives.

Membership in the Fund would also have its advantages for Canada on the creditor side. We have a vital interest in developing post-war trade into new areas to which our exports have hitherto been light. And yet because Canada is itself a raw material producing country, strictly bilateral trading arrangements with these areas would be limited by our inability to import large quantities of materials which

we produce at home. A truly multilateral system of trade within which Canada could in effect receive payment for exports by importing from any country within the system, is essential to a satisfactory development of our export potentiality. As part of such a system, and even before it is fully attained, the ability of other countries to obtain limited amounts of Canadian dollars through their borrowing privileges under the Monetary Fund, could be a helpful and automatic supplement to the longer term, more direct, and more ambitious methods of lending abroad that we shall undoubtedly have to undertake as a necessary concomitant of our over-all creditor position.

Canada has very little past experience as a creditor nation to draw on. It is quite true that in the years 1935-39 Canada was a creditor nation on international account, to the extent of approximately $150 millions annually. But our problem of foreign investment was solved for us, automatically and painlessly by the existence of two factors:

(a) sterling was freely convertible into United States dollars;

(b) we had a substantial amount of external debt in the United States, which it was good business to retire and to refund in the Canadian market.

What Canada did in effect during those years was to gather up surpluses arising in our trade with the United Kingdom and with the rest of the world other than the United States, to use some of these surpluses in balancing our current position with the United States and to use the rest to retire debt in that country.

In the post-war years we shall have to solve our problem of capital exports without the assurance that we can do it in the easy and riskless manner of 1935-39. We shall have to acquire the techniques and mental attitudes of a foreign lender. Now the field of foreign lending is full of pitfalls at the best of times; and there is no way in which the elements of uncertainty can ever be removed. But for Canada, the existence of the International Bank for Reconstruction and

Development could be of no little value in spreading some of the risks and in removing some of the uncertainty attendant upon the foreign lending that we shall undoubtedly have to do if our aspirations to a high level of trade and employment are to materialize.

Announcing . . .

Behind Dumbarton Oaks

By W. L. Morton

Vol. 5, No. 2, Behind the Headlines

10c; bloc orders, 7c

"It is true that the relations of states are lawless," writes Mr. Morton, but "there are . . . three alternatives to international anarchy." One of these three alternatives is the basis of the Dumbarton Oaks plan. But the plan depends on close collaboration among five Great Powers. Can we assume that the Big Five will work together? Where will Canada stand? These are the questions in all our minds today. Stripping the crucial problems of wordy enthusiasm and melodramatic pessimism alike, Mr. Morton gives a historian's straight-forward analysis, in direct, sometimes brutally direct, terms. For Canadians willing to face the issues of our times courageously, this pamphlet is highly recommended.

The World is Our Oyster

By Kenneth R. Wilson

Vol. 4, No. 7, Behind the Headlines

10c; bloc orders, 7c

We have heard much of late about Canada's rank among the powers, our wealth, the industrial boom, our glowing future. Mr. Wilson's thoughtful statements provide a solid vantage point from which the reader can assess these. The economic status of Canada is his first topic. Against this background he discusses our role in food and agriculture plans, UNRRA, currency and aviation programmes, the security organization. Under the heading "Trade and Tariffs", Mr. Wilson fills in the picture of our present situation and its promise, in terms which challenge superficial thinking.