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INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

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Speech of Honorable J. W. Beyen, Executive Director for Holland and Union of South Africa of the International Bank for Reconstruction and Development, to the Savings Bank Association of the State of New York at their Annual Meeting held at Chateau Frontenac, Quebec, Canada on October 14, 15 and 16.

I think it is right to stress the special significance of this occasion. The International Bank for Reconstruction and Development - you will allow me to call it the International Bank in my further address - cannot fulfill the temendous task for which it has been created unless it can win and justify the confidence of the investing public. This is the first time that a representative of the International Bank publicly meets the representatives of a very important section of the investors on their invitation and is given the opportunity of discussing with them the objects, structure and plans of the Bank.

The Bank carries a great responsibility. It has been founded to foster the reconstruction of the war-stricken world and, as its Articles put it, "to encourage the development of productive facilities and resources in less developed countries". It is one of the most imaginative ventures in the field of international cooperation that the world has ever seen and great hopes are built on its achievements.

But great also is the responsibility of those who are trusted with the savings of the public. It is only with those savings that the economy of the world can be restored and developed. It is only by the restoration and development of the economy of the world that real savings can come into being and that existing savings can retain their real value. Ultimately economic development and the accumulation of savings are two aspects of the same phenomenon: the formation of capital or in other words the creation of wealth. In the last instance the Bank and the trustees of the investing public are confronted with the same task and aiming at the same object. Their ultimate responsibility is a common one. They fulfill each a different part of the task but they can only succeed together. It is essential therefore that they should understand each other's functions. It is my object today to make you understand ours; we realize that they are complementary to yours.

The International Bank is the twin sister of the International Monetary Fund. It is the task of the Fund "to promote exchange stability and to maintain orderly exchange arrangements among members". It is possessed of ample means to extend short term credit to its members. It is one of its purposes; "to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of its members". The Fund's resources however are not intended to be used for transactions that are not "current transactions". A country that is in need of large imports of a non-current nature, either because it has to rebuild its war-battered economy or it intends to undertake development projects cannot use the resources of the Fund for the financing of such imports. It will have to conclude long term loans for that purpose. In order to obtain such long term loans it has to apply to the investors of those countries that are possessed of surplus productive capacity. There is nothing new about that. The capital market of such countries is - usually - well organized to bring prospective borrowers and prospective investors together. The question arises why it was felt necessary to create a special international institution - an organ of the nations of the world - to help the capital markets fulfill a task which previously used to be fulfilled without such help. The answer is firstly that conditions in the world after the second war are such that, without such help, the capital markets of the "surplus countries" could neither be expected nor asked to provide the financing of the import needs of war-battered countries to the necessary extent; secondly that the experience of the 1920's has taught that in the labyrinth of after-war conditions international lending may without guidance lose its way and, thirdly, that even after the world has settled down, development programs may not be able to find adequate financing facilities through private channels only. The Bank, as is expressly stated in the first article of its statutes, is meant to promote private foreign investment, not to supplant it. If the Bank is successful in fostering the reconstruction of the world it will help create the conditions under which private foreign investment will again take its natural place in the world. Its ultimate task - apart from participating in such foreign investment and acting as a guiding and coordinating factor - will then be focussed on economic development instead of reconstruction. Financing of development is part of its task from the beginning. It will become its major task at a later stage and the knowledge it will gradually acquire in the field of economic development will - it is hoped - enable it to become one of the main promoters of world economic progress.

The member countries of the International Bank have made it their common cause to foster the reconstruction and development of the world. That means that they share the risk of any loan that will be given and are responsible for any obligation the Bank will incur. It means also that they have pledged themselves by their participation in the Fund and the Bank to cooperate in maintaining equilibrium in the international balance of payments - and everybody knows that disequilibrium in the balance of payments has - in the past - been the main cause of default in international indebtedness. Last but not least - no borrower from the Bank is only a borrower; he is always also a shareholder and has as such a direct interest in the soundness of the Bank's lending policy and the good behaviour of its borrowers; no borrower can set a bad precedent by his own behaviour without risking punishment as a shareholder for the influence his example may have on other borrowers.

Two questions are important to the investor who is asked to participate in international lending through the intermediary of the Bank: to what extent will it be possible for the Bank to avoid or help avoid the errors made in international lending in the 1920's and the catastrophic events that followed in the 1930's?

And what security does the Bank offer to the investor who has confided his money to it if the service of loans it is giving with that money - or which it has guaranteed - is not being paid notwithstanding its efforts to avoid such errors?

In answering the first question it is useful to recall briefly the unhappy history of international lending in the inter-war-period. After World War I it took seven years before the major economic and financial dislocation and disturbances that followed the cessation of hostilities were overcome. Around 1925 the depression that followed the after-war restocking boom was over. The currencies of those European countries that had been rocked by inflation were being reestablished on a stable basis. Most countries went back to the international gold standard, that is to an international system of currencies freely interchangeable at fixed "parity" rates of exchange. Confidence in the international economic situation was restored and international lending started to take place on an unprecedented scale. For a very large part this international lending was done on a short-term basis from money markets overflowing with money to money markets where money was in demand. Then, in the wake of the crisis of 1929, the situation in the borrowing countries deteriorated and in 1931 the lenders at short term lost confidence and started to call their money back. The lending on short term had created a semblance of equilibrium in the international balance of payments. The recalling of that money did not cause the dis-equilibrium, it only made it apparent. The world had been living in a fool's paradise and 1931 was its hard awakening. A process of disintegration set in that made some countries "go off gold" and forced others to introduce exchange restrictions. Before long the service of international long term loans became impaired. International trade, already hampered by protective tariffs before 1931, was encumbered more and more severely by a combination of monetary and commercial controls only partly justified by real balance of payment difficulties.

It is not the place here to go into a careful analysis of these unfortunate happenings or to describe how they created a favourable climate for the growth of the totalitarian aspirations that plunged the world into World War II. What asks for our attention in connection with the work of the International Bank are the errors committed before 1931 rather than the consequences of those errors afterwards. If one lesson can be learned from the events of the years after 1931 it is that once an economic and financial crisis has set in there is very little that can be done about it. Once a collapse of that kind has started because nothing was done to prevent it, it can no longer be stopped. The crucial moment for the prevention of the crisis of 1931 would have been the recognition in, or shortly after, 1925 that the fundamental disequilibrium in the world's economic and financial condition was still far from eliminated and that many factors fomenting disequilibrium were still at work. That short term lending took place on such an unprecedented scale was only because there was a fundamental disequilibrium in the balance of payments. If there had been equilibrium no such large amounts of money finding no employment in one country and flowing to fill the gap in others would have existed. I do not want to say that international bankers on the whole showed any better judgment of the situation than most of the politicians. But even the worst lack of judgment could not have led to international short term lending on such a scale if the situation had been sound; in a sound situation the glut of funds seeking short term investment would just not have been there.

The first requirement to avoid repetition of what happened in the second decade of the inter-war period is therefore a timely recognition of the situation and of the factors causing disequilibrium. Broadly speaking those elements are economic dislocation, caused by war, trade impediments, capital flight and heavy price fluctuations. In creating the two Bretton Woods organizations, the nations have equipped themselves with better instruments for the speedy recognition of such elements than they ever had at their disposal before.

The second requirement is that the right measures to cure the situation should be taken. The Bretton Woods organizations and the other international organizations existing or being built up under the augury of the U.N.O. should provide the machinery to find the right cure. They should also be able to prevent the application of methods that hide the defects of the situation instead of curing them such as the large scale short term lending that took place between 1925 and 1931. It is wise not to be too optimistic about what international institutions can do to avoid the errors that have been committed in the past. It is especially wise for those who lead such institutions to be diffident of what human insight can teach, Bankers, economists and even politicians should be modest; as the famous saying goes, they have a lot to be modest about. But the sufferings of the last twenty years have opened the eyes to many aspects that seem obvious now and were misjudged at the time. The "awareness" is immeasurably greater and international consultation and cooperation are being organized so as to enable consciousness to make a little more than just cowards of us all. There is reason to believe that, at any rate in the field of international lending, the chance of fundamental errors has been greatly reduced.

But however important that may be to the investor - and it is important to him not only in the negative sense that it will protect the investment he made but also in the positive sense that it enables productive use for his future investments - it is not enough. He has the right to ask what protection there is for him, in case unavoidable errors are committed and what risk he runs if unavoidable disasters occur. He has a right to know in which way the nations that cooperate to foster foreign lending do look after him, not only by their collective judgment but also by their combined financial strength.

To make that clear I have to end this address by "talking balance sheets". The International Bank has an authorized statutory capital of \$10 billion. Of this about \$8 billion has been subscribed at this moment.

might be defaulting. Also some of the shareholders might not be in a position to transfer the amount of their non-paid subscription when called to do so. But unless the total of such defaults by shareholders and debtors would surpass half of the total, that is ten billion dollars, the creditors of the Bank would not yet run any risk. Amongst the non-paid subscription of 8 billion dollars 2.540 hundred million are owed by the United States. 25% of the obligations are already covered by this claim and the remaining 7.5 billions are therefore covered by assets and claims totalling 17.5 billions. Amongst these assets a considerable amount will be, of course, held in liquid form in convertible currencies. One must take an extremely pessimistic view of the solvency of all the other member countries and of the sort of loans the Bank is going to give to assume that the obligations of the Bank would not be more than fully covered.

The loans to be given by the Bank will be loans to member governments or guaranteed by member governments or by its central bank or some comparable agency of the member government acceptable to the Bank. They will be for the financing of well defined projects of reconstruction and development. The Bank will not give any loans without careful study of such projects and the use of the money shall be carefully supervised. The Bank is being organized to carry out such studies and will have the best available information at its disposal because of its special structure and its close relations with the International Monetary Fund, other international organizations and the governments of its members.

It is with confidence therefore that the Bank is going to appeal to the investor and to ask for his cooperation in the carrying out of its task. The Bank is not supposed to undertake the <u>relief</u> of countries. It is equipped with the means to finance reconstruction and development wherever such reconstruction and development can be considered an economically sound undertaking. It can because of its strength and structure do more than the private investor could do directly at this moment. It can take risks the private investor would recoil from because it possesses a greater knowledge and because it is an agency of the nations themselves. Because of this greater knowledge it will on the other hand avoid risks of the kind sometimes taken by private investors in the past. It will not be lured into greater risks by the attraction of high interest rates, detrimental to the debtor and never a real compensation for the risk incurred. If it is successful it will see private international lending taking the field again. By that time it hopes to have established itself as a useful agency that will have its coordinating and constructive task alongside with private lending. It will need the confidence of the private investor then as it needs his confidence now though the relative proportion of the activities of the Bank and of private agencies may be different. As I said in the beginning of this address their aim and object are the same - it is only by the creation of wealth that savings can come into being and that their real value can be preserved. It is only thereby that the standard of living of the peoples of the world can be raised. It is with that object in mind that the Bank must get to work. It is for that object that it is asking your cooperation, conscious of the responsibility it has towards you and confident that it will justify your trust.

Dr. J. W. Beyen
Consultative Committee
on Information - Lake
Success
2/13/47

THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

1. At the moment this paper is written nearly eight months have elapsed since the Executive Directors of the International Bank for Reconstruction and Development held their first meeting. During those months an organization has been built up to deal with the Bank's business. The first Annual Meeting of the Board of Governors took place in Washington from September 27th to October 3rd. The Bank has called part of its capital and is busy considering a number of Loan Applications. The marketing of its bonds on the American market is in preparation. The Bank, in other words, is getting ready to do business but it has not done any business yet. Gradually the problems that it will have to solve in fulfilling its worldwide task are emerging from the dawn of theoretical discussion into the daylight of practical decisions. As was to be expected many of theseproblems show a difference in shape and proportion from what even the most visionary of the Bank's sponsors had forseen. Questions arise that escaped the eye of the planners. Whoever writes about the Bank at this instant must realize that many of its ultimate features can still only dimly be recognized. So far the lifting of the morning mist has taught him that the landscape is richer and more varied than his imagination made him expect. He is not yet able to draw a map. But he can try to describe the mountains he sees even if he cannot yet exactly determine their exact distance or height and has to make a guess as to the steepness of their approaches.

2. The Bank was conceived as an essential part of the international monetary system devised at Bretton Woods. No international monetary system can assure monetary stability in the world unless international capital movements are financed in an appropriate way. In a world, disorganized and devastated by war no such system can be built up unless the needs of reconstruction are met by adequate means and "private channels" cannot be expected to provide such means. Without the help of the Bank reconstruction would remain a dangerously slow process that would tend to upset the international balance of payments, thereby frustrating the best organized attempts at achieving international monetary stability. Relief and rehabilitation by grants in aid can do no more than lay the foundations for reconstruction. The war-ridden countries must put their house in order by their own effort. Whatever capital they need they must borrow and ultimately repay. No self respecting nation can accept it as a gift. The International Bank is based on the principle that the United Nations should carry the risk involved in the lending of such capital to any one of their members as a common risk because the reconstruction of the world is their common responsibility. This common responsibility, however, is not confined to the task of reconstruction. The war has shown that the potential productive capacity of the world at large is vastly greater than anybody expected. At the same time it gave birth to an acute consciousness of the economic backwardness still prevailing in wide areas of the globe. Economic development of those areas is felt to be a duty towards mankind shared by all nations.

3. The Bank is a financial institution intended to provide a

channel through which the savings of surplus countries can safely be invested into the reconstruction and development of other countries. As all banks it is devised to prevent impossibilities of finance from stifling the growth and barring the outflow of production. Its success in carrying out this task depends on the security it is able to offer to the investor. But at any given moment its activity - in scope and speed - is dependent on what the productive apparatus of the world is able to achieve.

In a world dislocated, disorganized and devastated by war that ability is reduced by many factors of a non-technical nature. The war has done more than destroy buildings and machinery and deplete stocks. Economic and political systems have been thrown over and disorganized. In the surplus countries adaptation to peacetime conditions has proved to be much more than a technical problem. The picture varies from one country to another. Reconstruction appears to be disconcertingly different from what was envisaged a year or so before the end of hostilities. On the one hand the capacity to get going, to patch up, to recover to some sort of normal life is much greater, here and there, than was expected. The stream of surplus goods into the war-ridden countries on the other hand is slower and narrower and the capacity to use them much more limited. Immediately after the liberation import needs for reconstruction purposes were glibly measured by individual countries in billions of dollars. Imperceptibly practical estimates have shrunk by now to hundreds of millions or lower.

4. The history of international investment since the first world war is far from happy. Nobody can blame the private investor for being scared of buying bonds of foreign countries in a world

turbulent with political troubles and struggling with the economic and financial desequilibrium caused by the war. He is bound to be haunted by unhappy memories and to be afraid of taking risks he cannot measure and that cannot be adequately covered by an interest rate, however highly geared. In order to induce him to lend his money for the purposes of international reconstruction and development, the Governments have decided that risk should be shouldered by the community of nations.

Section 2 of Article III of the Banks Statutes limits the total of the Bank's guarantees and borrowings to one hundred percent of its unimpaired capital, reserves and surplus. Twenty percent of the Bank's capital is paid up and eighty percent remains callable to meet the Bank's liabilities. Assuming that the full authorized capital of 10 billion dollars would be subscribed and that the Bank's operations were extended to its full statutary limits (and neglecting for the moment the existence of reserves and surplus) - the Bank would have 12 billion dollars in assets and eight billion dollars callable on capital against 10 million dollars outstanding liabilities. Its liabilities would therefore be covered two hundred percent. It is clear that as long as the Bank's operations remain below its statutory limit (and it is unlikely that they will ever reach this limit whilst they will certainly remain considerably below it for years to come) the covering will be proportionately higher than two hundred percent. The decisive question to the investor is of course how much of this covering he will consider as unimpaired, the minimum for complete safety being a hundred percent of the total liabilities of the Bank. Amongst the total he will find liabilities for non-paid capitalof member countries whose financial capacity he may not consider beyond doubt; he will find payments on capital in local currency the transferability of which he may question notwithstanding the clause that for the purpose of meeting the liabilities of the Bank all such currencies will be freely transferable; and he will find loans to countries whose ability to meet their international obligations he may not consider unimpeachable under conditions of stress. On the other hand he will find that 85% of the non-paid capital is in the hands of countries that have never defaulted on their international obligations. If we take a pessimistic view and assume that obly 75% would continue to do so (the United States, United Kingdom and Canada together have 48%) 60% of the liabilities would be covered that way leaving 40% to be covered by three hundred percent in assets amongst which assets there will be always a considerable amount in liquid assets in convertible currencies and several loans to countries whose credit is beyond doubt.

5. But the investor is not only interested in how he would be covered at any moment on the basis of a balance sheet. He is interested in an investment that is a source of regular income and the maturities of which are met as and when they are due. To assume this the Bank will under all circumstances have to maintain a considerable liquidity.

6. As indicated above 20% of the Bank's capital will be paid up. 10% was paid up by the end of November 1946 and the remaining 10% will be paid up by the end of May 1947. Two percent of the capital

has been paid in gold or dollars, whilst 18% are paid or will be paid in local currencies. Of these local currencies only the U.S.A. dollars will be freely available for the extension of laons. The other local currencies may be used in so far as borrowers are in need of them for the payment of imports from the respective countries but the consent of those countries is necessary for such use. For the moment the total amount of currencies other than U.S.A. dollars to be used for giving loans will be limited. The greater part of the holdings of such currencies - in so far as they are not used for local expenses - is to be considered merely as security for the liabilities of the Bank. According to the Articles of the Bank they are freely convertible for that purpose but no for any other purpose. The available capital of the Bank will consist therefore mainly of the two percent paid in gold or U. S. dollars (less certain deferments) amounting to about $146,000,000 plus the 18% payment by the U.S. Government and $571.500 million equals $717.500.000.

7. If the Bank is to playthe role in reconstruction and development entrusted to it, it will give loans to a much larger amount. Experience with loans given by U. S. agencies like the Export-Import Bank has shown that there will always be a considerable time-lag between the granting of loans and their actual use. As the Articles of the Bank prescribe that the Bank will permit the borrower to draw on the loan "only to meet expenses as theyare actually incurred" (Art II Sec. 5 Sub c), there will always be a relatively large amount of "commitments" to borrowers which the Bank will hage to consider as a liability and against which it will have to hold liquid assets, a "spread" which is bound to gorw as the business of the Bank expands. In how far it will be necessary to hold

liquid assets covering the full amount of this spread depends on various factors, the most important being the ready marketability of the Bank's debentures. But it is clear that a considerable proportion must be available in liquid form. In all probability total commitments will soon reach the amount of the Bank's "available" paid up capital. This means that the vailable part of the Bank's paid up capital must be largely considered as "working capital", or, in other words, that only a small part of it can be actually invested in loans, at any rate as long as the Bank is expanding. Ultimately, once the borrowings of the Bank are approaching the statutory limit, a situation will develop where theBank will not incur new commitments and then, gradually all the loans granted will be taken up. It is only in that stage that both the paid up capital and the money borrowed by the Bank would become invested in loans. But it will take a considerable number of years before that stage is reached. In the meantime the Bank will have been building up the special reserve, provided for in its articles, from the one to one and one half percent commission to be charged on all loans and guarantees (see Art. Iv Sec. 4, 5 and 6). This special reserve is to be held in liquid form and can only be used for the meeting of the Bank's liabilities. It is to be considered as a second expression of the principle of "mutual aid" contained in the structure of the Bank, in this case a "mutual aid" between debtors. It is clear that the Bank would always have to keep, in liquid form, sufficient funds to be able to meet its current obligations even before the special reserve fund has been built up. At any given moment of its development the Bank will therefore have sufficient liquid funds at hand to meet current liabilities, and ample time to call in, as far as necessary, non paid capital.

8. The Bank's income will consist of interest on its short term investments, interest on loans, and, possibly, commissions to be paid on commitments to borrowers. The statutory Commission mentioned above is not free income but rather a contribution to a pool. The Bank's current expenses should be relatively low as the Bank has no day to day business, and only deals with a limited number of clients. It needs a high grade staff but not a very large one. The current expenses should be largely overcovered by the income in the Bank's "working capital", which if calculated at an average of 1% would yeald more than $7 million a year.

9. Income from interest on loans and commissions, plus a surplus on income from liquid investments is destined to cover interest charges on the Bank's debentures. Although, as we have seen, the holders of such debentures are well covered against the risk of default from the side of the Bank's borrowers, the Bank, as a going concern, depends on their solvency. The Bank is scheduled to make it possible for the investor to invest his savings in international reconstruction and development. The member countries, as has been said, shoulder the risk of such investment. But it is not the intention that the Bank should take bad risks. Article III Section 4 Sub 5 expressly states that the Bank shall pay due regard that "the borrower will be in the position to meet its obligations under the loan". The borrower, it should be noted, (or the guarantor) is always a member country.

10. The impossibility for a country to meet its external obligation is nearly always caused by transfer difficulties. The solvency of the Bank's debtors depends therefore on the Fund's

success in making currencies "convertible", or in other words on the establishment of an international monetary system that can stand the stress of a world crisis. The future of the Bank as a going concern depends therefore ultimately on the success of the whole system of international economic cooperation that is being embodied in such international institutions as the Economic and Social Council, the International Trade Organization, the International Monetary Fund and F.A.O. and the Bank itself, and last not least on the securing of world peace by the U.N.O. It should not be thought, however, that the Bank's existence depends on the immediate and complete success of such organizations. The Bank is strong enough to weather minor storms and even major storms provided the latter are of limited duration. Acute transfer difficulties of a world-wide nature have, so far, mainly been caused by sudden movements of capital either in the form of capital flight (hot money) or in the form of withdrawal of short term international investments. There is every reason to believe that capital flight of a major scope can and will be prevented in the future even after currencies have become "convertible" whilst short term international lending is unlikely to take place on anything like the dangerous scale it was undertaken in the late twenties.

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BRETTON WOODS

I.B.R.D. NAT.ZTG, BASL.NACHR., 11/5, report on a lecture on the I.B.R.D. given by Dr. J.W. Beyen, Executive Director of the I.B.R.D. and the I.M.F., on 10th May, to the Basle Statistical Society.

The speaker, after pointing to the manifold problems that arose as a consequence of the war, paid tribute to the reconstruction effort made by the war-devastated countries of Europe, which required financial support from countries which, in spite of the war, still possessed surplus production capacity. The realisation, in 1944, that reconstruction would be impossible without substantial foreign capital investments in the war-devastated countries gave birth to the I.B.R.D. The Bretton Woods system, which aimed at restoration of an orderly monetary world system with free and stable currencies, would have been incomplete without the Bank. But the conception of free and stable currencies presupposed a system of foreign trade that was not concentrated in the hands of Govts, lest the exchange rate should be relegated to a mere instrument for settling accounts in transactions between the Govts concerned, thus losing direct influence on the formation of prices at home. In such a world the Bretton Woods system would be a meaningless fiction. What was needed was a revival of international capital movements to make possible the reconstruction of a "non-etatiste" economy. But such an international movement of capital could not be expected from purely private economic sources, because of the political risk involved and the lack of confidence in the success of reconstruction. The International Bank had been created to relieve private capital investments of the political risk and to break the vicious circle within which lack of confidence in the success of reconstruction prevents capital investment and lack of capital investment makes reconstruction impossible. The basic principle followed by the I.B.R.D. was to let this risk be assumed by the participating countries together, in proportion to their financial capacity, and not to replace private capital investments by international Govt loans. If the Bank was successful its activity would necessarily be limited in point of time. In the field of reconstruction the Bank's ultimate task was to make itself superfluous. On the other hand it was to be expected that the development of backward areas would also, in the long run, make demands on the international capital market which would not adequately be met solely by private financing. It was to be expected that the Bank would gradually gather such experience in international financing that it would become an indispensable factor in the international financial system even of the more distant future. Although the financial resources required for reconstruction had been assessed at a much higher figure than the Bank's capital, the pace of reconstruction was determined by the available surplus of production capacity throughout the world - not only by the surplus in the capital-exporting but also by that in the capital-importing countries. In practice, the Bank had been confronted with a number of difficulties - partly unforeseeable and partly under-estimated - which had substantially restricted its early activities. It had been clear, from the outset, that in the early years of the Bank the private investor would only in certain cases accept the guarantee of the participating countries for the Bank's capital at its full value. Moreover, it had to be expected that, during the reconstruction period, only a limited number of countries would be able to afford capital investments abroad. But owing to political and economic post-war developments, only the U.S., practically speaking, was regarded as providing a full guarantee, being the only capital market able, for the time being, to undertake international investments on a substantial scale via the Bank. Experience had shown that, while the U.S. capital market was quite capable of absorbing bonds of the Bank, this took place on a smaller scale than had originally been expected. But far more important than this limitation of the early activities of the Bank had been the discovery that the reconstruction ideal embodied in the Bretton Woods institution would not be realisable by means of capital raised from private investors. While the European countries had made a laudable reconstruction effort, they had greatly under-estimated the demand on available foreign means of payment and foreign credit resources by the actual pace of reconstruction and the targets set. Unforeseen military expenditure, unfavourable price developments in supplier countries and a bad harvest had caused insurmountable balance-of-payments difficulties in the countries concerned. The U.S. had decided to act vis-a-vis Europe, for a number of years, not only as a supplier of capital but also as a bearer of losses - a decision based on the realisation that an economic system in accordance with the conceptions of the U.S. could not be maintained if reconstruction was not rendered possible together with the preservation of a certain standard of living. It would be a mistake to assume that this blood transfusion was at the same time a useful blood-letting for the donor. The surplus of production capacity in the U.S. was by no means so great or so general that Marshall aid merely represented a necessary utilisation of otherwise idle labour and machines. Had this been the case the U.S. would have had no need to worry, as in fact it did, about the inflationary effects of Marshall aid, and to postpone a much desired cut in taxes in order to make possible the budgetary financing of this relief action. Marshall aid constituted a real sacrifice on the part of the citizens of the U.S. Referring to the Bank's role in relation to the Marshall Plan, Dr. Beyen stated that only as the result of that plan could the Bank take in hand the tasks for which it was designed, since the Marshall Plan would do no more than create the conditions under which true reconstruction could really be undertaken. It would lay the foundation for such reconstruction, and, at the same time, create the conditions for the further development of non-European continents - which would only be possible to a limited extent unless Europe revived. The I.B.R.D. was still in the stage of development for its great task, and the interesting aspect of this task was the close collaboration it involved with private finance. The management of the Bank was looking forward to the time when it would be able to internationalise the Bank's activity so that it would no longer be dependent on one capital market alone. In this connection Dr. Beyen referred in particular to Switzerland, expressing the hope that the Swiss bankers would be prepared to cooperate with the I.B.R.D.

In the course of the following discussion, a Swiss banker expressed the view that the Swiss banks would be prepared to cooperate with the I.B.R.D., but emphasised that the terms and conditions for the participation of Swiss capital must necessarily conform to those prevailing on the Swiss market. This applied, in particular, to the rate of interest offered to would-be investors in I.B.R.D. bonds.

Speech by Dr J. W. Beyen May 10, 1948
Basle Statistical Society
Basle, Switzerland

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BANK FOR INTERNATIONAL SETTLEMENTS

No. 91

Press Review

Basle, 12th May 1948

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Statement of Account NAT.ZTG, 12/5. The statement of account for April shows an increase in the balance-sheet total from Swiss gold francs 555.8 million to 562.4 million.

BRETTON WOODS

I.B.R.D. NAT.ZTG, BASL.NACHR., 11/5, report on a lecture on the I.B.R.D. given by Dr. J.W. Beyen, Executive Director of the I.B.R.D. and the I.M.F., on 10th May, to the Basle Statistical Society.

The speaker, after pointing to the manifold problems that arose as a consequence of the war, paid tribute to the reconstruction effort made by the war-devastated countries of Europe, which required financial support from countries which, in spite of the war, still possessed surplus production capacity. The realisation, in 1944, that reconstruction would be impossible without substantial foreign capital investments in the war-devastated countries gave birth to the I.B.R.D. The Bretton Woods system, which aimed at restoration of an orderly monetary world system with free and stable currencies, would have been incomplete without the Bank. But the conception of free and stable currencies presupposed a system of foreign trade that was not concentrated in the hands of Govts, lest the exchange rate should be relegated to a mere instrument for settling accounts in transactions between the Govts concerned, thus losing direct influence on the formation of prices at home. In such a world the Bretton Woods system would be a meaningless fiction. What was needed was a revival of international capital movements to make possible the reconstruction of a "non-etatiste" economy. But such an international movement of capital could not be expected from purely private economic sources, because of the political risk involved and the lack of confidence in the success of reconstruction. The International Bank had been created to relieve private capital investments of the political risk and to break the vicious circle within which lack of confidence in the success of reconstruction prevents capital investment and lack of capital investment makes reconstruction impossible. The basic principle followed by the I.B.R.D. was to let this risk be assumed by the participating countries together, in proportion to their financial capacity, and not to replace private capital investments by international Govt loans. If the Bank was successful its activity would necessarily be limited in point of time. In the field of reconstruction the Bank's ultimate task was to make itself superfluous. On the other hand it was to be expected that the development of backward areas would also, in the long run, make demands on the international capital market which could not adequately be met solely by private financing. It was to be expected that the Bank would gradually gather such experience in international financing that it would become an indispensable factor in the international financial system even of the more distant future. Although the financial resources required for reconstruction had been assessed at a much higher figure than the Bank's capital, the pace of reconstruction was determined by the available surplus of production capacity throughout the world - not only by the surplus in the capital-exporting but also by that in the capital-importing countries. In practice, the Bank had been confronted with a number of difficulties - partly unforeseeable and partly under-estimated - which had substantially restricted its early activities. It had been clear, from the outset, that in the early years of the Bank the private investor would only in certain cases accept the guarantee of the participating countries for the Bank's capital at its full value. Moreover, it had to be expected that, during the reconstruction period, only a limited number of countries would be able to afford capital investments abroad. But owing to political and economic post-war developments, only the U.S., practically speaking, was regarded as providing a full guarantee, being the only capital market able, for the time being, to undertake international investments on a substantial scale via the Bank. Experience had shown that, while the U.S. capital market was quite capable of absorbing bonds of the Bank, this took place on a smaller scale than had originally been expected. But for more important than this limitation of the early activities of the Bank had been the discovery that the reconstruction ideal embodied in the Bretton Woods institution would not be realisable by means of capital raised from private investors. While the European countries had made a laudable reconstruction effort, they had greatly under-estimated the demand on available foreign means of payment and foreign credit resources by the actual pace of reconstruction and the targets set. Unforeseen military expenditure, unfavourable price developments in supplier countries and a bad harvest had caused insurmountable balance-of-payments difficulties in the countries concerned. The U.S. had decided to act vis-a-vis Europe, for a number of years, not only as a supplier of capital but also as a bearer of losses - a decision based on the realisation that an economic system in accordance with the conceptions of the U.S. could not be maintained if reconstruction was not rendered possible together with the preservation of a certain standard of living. It would be a mistake to assume that this blood transfusion was at the same time a useful blood-letting for the donor. The surplus of production capacity in the U.S. was by no means so great or so general that Marshall aid merely represented a necessary utilisation of otherwise idle labour and machines. Had this been the case the U.S. would have had no need to worry, as in fact it did, about the inflationary effects of Marshall aid, and to postpone a much desired cut in taxes in order to make possible the budgetary financing of this relief action. Marshall aid constituted a real sacrifice on the part of the citizens of the U.S. Referring to the Bank's role in relation to the Marshall Plan, Dr. Beyen stated that only as the result of that plan could the Bank take in hand the tasks for which it was designed, since the Marshall Plan would do no more than create the conditions under which true reconstruction could really be undertaken. It would lay the foundation for such reconstruction, and, at the same time, create the conditions for the further development of non-European continents - which would only be possible to a limited extent unless Europe revived. The I.B.R.D. was still in the stage of development for its great task, and the interesting aspect of this task was the close collaboration it involved with private finance. The management of the Bank was looking forward to the time when it would be able to internationalise the Bank's activity so that it would no longer be dependent on one capital market alone. In this connection Dr. Beyen referred in particular to Switzerland, expressing the hope that the Swiss bankers would be prepared to cooperate with the I.B.R.D.

In the course of the following discussion, a Swiss banker expressed the view that the Swiss banks would be prepared to cooperate with the I.B.R.D., but emphasised that the terms and conditions for the participation of Swiss capital must necessarily conform to those prevailing on the Swiss market. This applied, in particular, to the rate of interest offered to would-be investore in I.B.R.D. bonds.

Mr Ralph Forster

J.W. Beyen

SPEECH AT BURLINGTON (VERMONT) ON SEPTEMBER 12th 1948

The Future of International Investment

1. That the economic development of the world is dependent on international investment is a truth that need not be stressed in the United States. During centuries countries having a surplus of productive capacity - in the widest sense of the word - have used that surplus to develop areas of the world that for some reason or other lacked the wherewithal to develop their natural resources. Every investment carries risks. Those risks are taken because of the rewards that are expected if the undertaking proves a success. Apart from such risks as are normally involved in every investment, international investments carry special risks of their own. The path of international investment never did run smooth no more than that of true love. In both cases, however, success brings rich rewards.

2. The United States entered the field of international investment on a big scale only after the First World War. In a world distorted by war it found itself quite suddenly in the position of a large creditor nation with a considerable surplus in productive capacity. Its experience in the field of international investment has been extremely disappointing. Most of what seemed to be opportunities appeared to be pitfalls. A hurricane is not the right occasion to learn how to sail a boat. When you come out alive you have only learned to be scared. The main impression left on the minds of the United States foreign investor after his experiences in the interwar period is one of intense distrust.

3. From the Second World War the United States emerged as the largest creditor nation and as virtually the only country with a surplus productive capacity. This

time, however, international investment does not even tempt with opportunity. It appears as a far from attractive necessity to get the disorganized world on its feet. It is not a matter of taking exceptional risks in the hope of reaping high rewards. It is a matter of avoiding greater general risks by taking smaller ones of a definite character. There is not much to attract the private investor into a field like that. And still, to the American mind, international investment and international trade should not become purely a government affair.

4. The International Bank for Reconstruction and Development was created to solve this problem. Its task is to foster international investment not of government money but of private investor's money by taking over the special risks the private investor cannot be expected to run. It should at the same time conduct international investments in such a way as to avoid the pitfalls that caused the collapse of international investment during the interwar period. What were those pitfalls and what can the International Bank do to avoid them? What has the International Bank to offer to the private investor to induce him to use his savings for international investment?

5. Though ~~the~~ lack of judgment in choosing and arranging individual international investments did play a part in bringing about the disappointments of the thirties, it would be a great mistake to think that such lack of judgment was the main cause of the consequent failures. It was rather a failure to recognise the dangers contained in the situation of the debtor countries in general than a lack of judgment regarding the situation of the individual debtors in particular that caused the general collapse.

6. However important it is to avoid in the future the extension of loans to unworthy debtors or of loans in a form inappropriate to the character of the

investment, it is more important that foreign investment should be based on a thorough knowledge of the situation and prospects of the country where the investment takes place. In the twenties, international investment in Europe was done on too large a scale with short term money; it was given to countries whose internal financial situation was built on unsound principles; it financed balance of payment deficits caused not merely by the imports of capital goods and raw materials needed for the reconstruction of war damaged economies but also by reparation payments and capital flight. (Let us not overlook that this happened notwithstanding the fact that an international institution, the Office of the Agent General for Reparation Payments studied the situation in the most important of the debtor countries and reported on it regularly.) No care in the choice of the purposes of any investment nor control against the abuse of money put at the disposal of debtors, how useful it may be, can be of avail, if the general situation of the debtor is such that the most carefully chosen and controlled investment becomes infected by the general unsoundness of that situation.

7. The Bank can offer the private investor the protection of its capital structure either in placing bonds on the market and undertaking foreign investments out of the money it borrows from the market or by guaranteeing investments made by private investors. One can envisage various forms in which the Bank can use its guaranty or its lending capacity to participate in private investment.

8. Though the Bank is intended to take risks the private investor would shy away from, it is not supposed to enter into operations that have not got the character of investment. It has become clear that the dollar needs of the reconstruction of Europe caused balance of payments deficits that could only partly be covered by loans

still having the character of investment. Hence E.R.P. The role of the Bank in the reconstruction of Europe will only gradually emerge as Europe's recovery arises out of the present stage where it has to be sustained by a large dollar-support that is not investment.

9. In the development field the Bank will find a steadily growing task. That this growth will be a relatively slow one is due to the fact that development of underdeveloped economies is a slow process which cannot be quickened beyond a certain limit without endangering the very objects of the development policy.

RECORDED BY THE UNITED NATIONS AT LAKE SUCCESS AND BROADCAST IN THE NETHERLANDS

RADIO INTERVIEW OF MR. BEYEN, MARCH 28, 1949

Q. 1 Mr. Beyen, you are one of the Executive Directors of the International Bank for Reconstruction and Development. You will understand that sounds rather technical to the ordinary listener. Would you tell us something about the operations of the Bank and how the Bank came into being?

A. Apparently it's never very clear to the man in the street what the function of a bank - of any bank, for that matter - really is. Years ago, the little son of one of my colleagues, a director of the Rotterdam Bank, asked what was his father's job, gave the answer, "He sits on a bench and reads the paper."*

At the Bretton Woods Conference where the twin institutions, the International Monetary Fund and the International Bank, came into being, a discussion took place between the great British economist Lord Keynes and Mr. Acheson, now Secretary of State, on the question whether the International Bank could really be called a Bank. According to Lord Keynes, the Bank was really a fund, and the Fund was really a bank. Mr. Acheson, however, stated that, according to American usage, the Bank should be called a bank. According to Dutch usage, it is also a bank, but a bank rather comparable to a mortgage bank than to a deposit bank.

What indeed is the task of the International Bank? The task is to channel savings available in surplus countries into investment in newly created capital in deficit countries. Those deficit countries need that capital for reconstruction, or, in areas where economic development is still in its early stages, for building up a modern apparatus of production. The Netherlands is a case of a country where the apparatus of production needs to be reconstructed. Mexico and Chile are cases where the apparatus of production has to be built up.

* In Dutch, the words for "bank" and "bench" are the same.

One realized at Bretton Woods that, in the first years after the war, investors would not be very keen on investing their money abroad and that, therefore, a special international bank was needed to attract foreign capital for reconstruction. As to the economic development of less developed countries, it was assumed at Bretton Woods that such development would demand more foreign capital than could be attracted without the help of an international bank, even in the more distant future. It was this line of thought that gave birth to the International Bank. On the strength of its share capital, in which forty-seven nations participate, the Bank can either borrow funds itself and use those funds for giving loans for reconstruction and development, or make such loans possible by guaranteeing interest and amortization to the investor.

Q. 2 Can you tell us what loans the Bank has given so far?

A. The Bank has given the following loans: for Reconstruction: to the Netherlands - \$207 million (about 550 million guilders); and to France, Luxenbourg, Denmark, and Belgium together, \$380 million; for Development: to Chile, Mexico and Brazil together a little over \$125 million. At this moment, the loans given by the Bank, therefore, total around \$650 million, of which nearly one-third has been lent to the Netherlands.

Q. 3 What have been the results so far, or is it perhaps too early to talk about them?

A. What results? It is, of course, only possible to say something about the results of the earlier loans, e.g. those to the Netherlands, France, Luxembourg, and Denmark. The answer in those cases is relatively simple. If, for example, the Netherlands would not have obtained a loan of around \$200 million in the Summer of 1947, it would have been forced to slow down its reconstruction just a year before the Marshall Plan went into operation. The unfavorable consequences of such slowing down would have extended beyond the lack of \$200 million. Reconstruction is a continuous process and the consequences of an interruption of that process spread out widely. Not only is the productive effect of the reconstruction postponed, but the whole plan of reconstruction is upset, with all the unfavorable effects that has for the raising or even the maintenance of the standard of living.

Q. 4 Could you tell us a little more about that?

A. Of course. Before the war, the Netherlands was a rich country, and an important part of its imports were paid for out of income from foreign assets. I don't need to tell you that many of these foreign assets have disappeared as a consequence of the war and its aftermath. One has only to think of our investments in the United States, our industrial possessions in Germany, not to speak of the Far East. Part of these assets were used to pay for imports during the first years after the liberation. In view of this decrease of our foreign assets, we have to produce more than we produced before the war, if we want to prevent a major decline in our standard of living. That in itself is no tragedy; we are an industrious and enterprising people and our population is increasing continuously. But in order to produce enough to protect our standard of living, we need tools, in fact more tools than we had before the war. Our first task after the liberation was to repair our apparatus of production and now our task is to extent and develop that apparatus. That is a rewarding but by no means an easy task. If we want to attain our objectives, we must work at that task without interruption. The enthusiasm with which the Dutch went to work after the liberation and the rapid improvement brought about in the years after May 1945 have shown that we are prepared to work hard. But imagine that in the second year, just when results began to appear, the work had had to be even partly interrupted because raw materials and equipment which could come only from foreign sources could no longer be imported or could only be imported at the expense of a reduction in the slight recovery in the standard of living that had just been achieved. One does not need much imagination to understand what this would have meant, not only in terms of well-being, but also in terms of discouragement, and to what extent the favorable effect of Marshall help would have been reduced. There is no doubt, therefore, that it has been a blessing to the Netherlands that the International Bank existed and gave this loan. As the Netherlands will in the future surely need foreign capital on top of Marshall help - and will need such capital all the more, if the reconstruction of the Netherlands is successful - the help of the International Bank will remain of invaluable importance to our country.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

Address by J. W. Beyen, Executive Director for the Netherlands and Norway for the International Bank for Reconstruction and Development,
Before the 52nd Convention of the Nebraska Bankers Association
Lincoln, Nebraska
October 12, 1949

THE PLACE OF THE INTERNATIONAL BANK IN THE PRESENT WORLD MONETARY PROBLEMS

You were kind enough to invite me to speak to you on the monetary problems of the day and on the role played by the Bank in the endeavors to solve those problems. It has been my good fortune that you did not invite me a month earlier. Not only that I know more than I knew four weeks ago, I can talk more freely also.

I find myself talking to you at a moment when monetary history has just passed a "milestone." In considering what I would say to you about that milestone I remembered a notice in the middle of the Skyline Drive in Virginia: "No refueling for the next so and so many miles." I think indeed that this is the moment to refuel our minds with fresh ideas for the next few years.

In contrast to what we find on the Skyline Drive we have no clear indication of the distance to be covered during those years.

We know that it is the distance from here until the end of the "postwar transitional period," to use the language of the Bretton Woods Fund Agreement. The end of that period will be reached as soon as the freedom of exchange of currencies has been reestablished. The reestablishment of that freedom will be the sign that production and trade in the world have found a new equilibrium after having been completely dislocated by the second World War.

A time-table has been set for the covering of the distance between the milestone we have reached now and the point on our voyage where that equilibrium is reached: Marshall aid will come to an end in 1952. That means that in 1952 the transitional period should be over. Whether the world will be able to cover the distance according to that time-table may be open to doubt. One can never be absolutely sure that one can cover a certain distance within one's time-table. Personally I do not consider the Marshall Plan time-table unattainable. When you ask a peasant boy in my country how far the distance is between where you are and the next village, he will not say "so many miles," he will say "about an hour's walk." In the same way we can say that from the present milestone to the end of the transitional period is "about three years."

I must explain to you why I consider the present moment as being a milestone. The obvious explanation would be, of course, that it is marked by the devaluation of the majority of non-dollar currencies in terms of the dollar. But there is more to it than that. Devaluation on a scale as happened last month is not accidental. We feel inclined to ask ourselves why such devaluation should not have marked the end of the transitional period rather than a little over the middle of it. The fact that devaluation happened already now seems an indication that the transitional period somehow falls apart in two subperiods and that - apparently - we have reached the end of the first of those subperiods. If that is a correct assumption, it teaches us something that we did not realize when the transitional period began. The "Founding Fathers of Bretton Woods" - of whom I am a cousin - stated in the Fund Agreement that the transitional period would be a period of "change and adjustment." They realized that it would be a period of reconstruction but neither the Founding Fathers nor - as far as I know - anybody else, foresaw that the main adjustment would take place after, not during the period of reconstruction. It is not surprising that they did not foresee it. Reconstruction was to aim at reestablishing equilibrium in production and trade. It was logical to expect that the productive apparatus of war-stricken countries should be rebuilt with a view to adapt it to the changed conditions in the world. We find now that the period of reconstruction is largely over: the productive capacity of most war-stricken countries, at least in Europe, is restored to pre-war level or has risen considerably above that level. But, however great a success that may be in itself, it leaves the reconstructed countries with the problem of the disequilibrium in their balances of payments - of which problem the so-called dollar gap is the most baffling aspect.

The problem of the dollar gap is the problem of adapting the scope, pattern and cost of the countries outside the dollar area so that they can pay with their products for the goods they need from the dollar area. That problem, as we all know, is far from solved. In other words, though reconstruction in Europe is largely over, it has not yet brought the adjustment of which the Bretton Woods Fund Agreement speaks. There has been - and is - constant disappointment, irritation and sometimes indignation about the persistence of the dollar gap, in other words about the slowness and inadequacy of this "adjustment." The indignation is enhanced by the thought that reconstruction was so enormously - and so generously - expedited by the billions of dollars of E.R.P. The disappointment is provoked by the fact that optimistic statements about recovery in Europe are invariably followed by some sort of dollar crisis. Both the indignation and the disappointment would lose much of their sting if it were realized that reconstruction and adaptation are not the same thing. If it is true, that, in the main, adaptation can only start after reconstruction is completed there is not yet any real reason for discouragement - still less for indignation - about the slowness and inadequacy of the process of adjustment. For, if it is true, the process of adaptation has only just begun.

Why is it that - in contrast to what seemed logical - adaptation could not take place simultaneously with reconstruction? Were all those who planned reconstruction so blind and stupid as to overlook that reconstruction was not simply a matter of rebuilding what had been destroyed on the pre-war pattern? Did not they realize that the world had changed forever, that creditor countries had become debtor countries, that conditions in and relations with Asia had changed, that there was an iron curtain with fewer and fewer loopholes, that there was the special problem of Germany and Japan?

Let me try to give you my answer to these questions in describing to you what happened in my own country. Holland in 1939 was a very rich country; it was since hundreds of years a creditor country with a currency as hard as any currency could be. It had been a shipping nation since before the event of which we celebrate the 457th anniversary today. Its trade covered practically every part of the globe. As a center of international banking it could match its experience, knowledge and tradition even with the London market. Favored by a fertile soil and a mild climate it had perfected its agriculture and horticulture. Without any protection against foreign competition it had built up industries selling their products all over the world. Its plantations in Indonesia provided the world with a major part of its raw materials. Holland's investments in industrial enterprises in Germany totalled over a billion dollars. For more than a century its investors had taken part in the development of the prosperity of the United States. In 1939 it ranked as the second largest foreign investor in American securities. Quite naturally Holland paid for its imports from abroad with the income derived from foreign investments, shipping, trade and banking. Its rapidly increasing population enjoyed a very high standard of living. Good education was available for everybody, and, thanks to a government-sponsored scheme to foster and finance the building of small houses, municipalities and farsighted industrialists had raised housing conditions for industrial and agricultural laborers to an exemplary level.

Now imagine for a moment what the war did to this country.

In May 1945 Holland had spent a large part of its foreign investments in financing its war effort. In a number of its larger cities whole quarters had been razed by bombardments and warfare. Large areas of arable land were flooded. Its highly modernized railway system was destroyed. The bridges over its many large rivers had been blown up. Many a factory had been destroyed while everywhere maintenance had been neglected during five years. All stocks of foodstuffs and raw materials had been depleted. Holland's livestock had been reduced to a little over half of what it was before the war. Indonesia had become a large liability instead of a source of income. Industrial investments in Germany would not yield any income for years to come. Holland's population had been starved during the horrible winter of 1944/45. Displacement of workers had disorganized its labor force. Its internal financial strength had been diluted by the occupation power's issues of paper money. Externally its currency, once one of the proudest on the world's market had "softened" to a degree that filled one with dismay.

Then, immediately after the liberation, Holland, helped generously by aid from the United States in various forms, went to work at rehabilitating the human and reconstructing the mechanical factors of production. Do you imagine that it was possible to design a blueprint for that reconstruction aiming exactly at giving Holland its place in the newly balanced economy of the world six to seven years hence? Could anybody have devised a plan indicating what Holland should produce beyond what it used to produce before the war, so that it could pay by exports for that part of its imports it had always paid for out of foreign income? Would a system of free enterprise have given the correct incentives to investment - not too much incentive here, not too little there - so that after a number of years of investment Holland's productive apparatus would have produced exactly those products demanded by the markets of the countries from where those imports were to come - markets for the greater part completely new and unknown to Holland's manufacturers? Holland first had to live, it had to patch up what was left of its apparatus of production. It had to get its economy going again before it could even think of redirecting its production into new channels or investing capital into new or extended production. And, Holland was not the only country in this position. Surrounding it were other countries in similar if not the same condition with similar problems of adapting and extending production and redirecting their trade, all busy patching up what was damaged, rebuilding what was destroyed and only after that starting to feel their way towards the unknown goal of a pattern of trade emerging out of their only feebly coordinated efforts. Since 1947 an intergovernmental organization to coordinate those efforts has been created. I am thinking of the O.E.E.C. the European counterpart of E.C.A. Much confusion has been and will be avoided through the good offices of this institution. But not even with the greatest human wisdom and disinterestedness could that institution have achieved a complete synchronization of the restoration of productive capacity with the adjustment necessary to reestablish a balanced world economy.

Now if indeed the "postwar" transitional period falls apart in two subperiods and if the first subperiod that of reconstruction has come to an end, what is the particular significance of the fact that this "milestone" was marked by wholesale devaluation of currencies in terms of the dollar?

As I said before, devaluation on a scale as happened last month cannot be accidental. Whoever has lived through similar landslides of devaluation in the past knows that they happen when conditions are ripe for it. Maybe the most striking truth, brought home by the events of September, is that government control of currencies does not greatly increase the freedom of governments to choose the moment of devaluation, nor, in many cases, its extent. Apparently the time was ripe for a general currency alignment. It does not seem an unwarranted speculation to assume that this ripeness was brought about by the completion of what I called the first subperiod of the postwar transitional period, the period of postwar reconstruction.

The rate of exchange between currencies defines the economic relations between countries: the rate at which one can exchange one's home currency against the currency of another country ultimately determines at what price one can buy goods from that country - or, seen from the other side - at what price goods produced in one country can be sold in another country. This is true, even though tariffs modify those prices and exchange and import controls limit the free choice to buy imported goods rather than home goods or imported goods from one area rather than imported goods from another area. As production and consumption in most countries depend on the use of imported goods, to be paid for by exported goods, the rate of exchange is a decisive factor in the cost and price structure. World economy can be in equilibrium only if trade between countries balances on a multilateral basis. Such equilibrium in world economy is therefore conditioned by the establishment of a network of exchange rates under which a balance can be obtained. Fortunately it is not true that there is only one set of exchange rates that would enable that balance to materialize. But the choice of exchange rates determines under what pattern of world production and trade the balance will be struck; it determines also in how far it can be struck without government interference in foreign trade by tariffs, quotas, exchange control and the like. An exchange rate may be so far out of range that a balance cannot be obtained without effects on the social and economic structure of countries that would be humanly or politically unacceptable. In that case unbalance will persist and result in losses of foreign exchange reserves which cannot be endured beyond a certain point. I will not complicate the picture by referring to the influence on all this of international movements of capital. Bankers know enough about that from their own experience to realize what this influence can be. The fundamental truth that no pattern of world production and trade can be in balance without appropriate rates of exchange is not affected by them.

At the end of the war the balance of the world's economy was completely upset. At that moment one could not talk at all about an existing pattern of world production and trade. One could only think of appropriate exchange rates in terms of the future pattern of production and trade to be established during the transitional period. The exchange rates prevailing immediately after the war were determined partly by their history (like the sterling-dollar rate), partly by some vague guess about the needs of a country's economy during the period of reconstruction. They were certainly not determined in relation to a pattern of production and trade that would gradually emerge during the next five to seven years. We have seen that it was impossible to reconstruct and adjust the world's productive apparatus simultaneously in one and the same period. It was no less impossible to choose appropriate exchange rates in the early stages of the reconstruction period. By the same token, however, it even seems too early to make the choice of appropriate exchange rates at the end of the period of reconstruction as has happened now. For even at this moment the general outline of the future pattern of world production and trade had not yet become clear to the eye. But as we have said, the time for devaluation appeared to be ripe. What we have to ask ourselves is: why the time was ripe?

In order to answer this question we must consider what happened to the economic and financial structure of the various countries during the reconstruction period.

Any after-war period is normally a period of heavy investment. It is usually the period of a seller's market, investment bringing increased purchasing power in the hands of the consuming public before increased production (to be created by the investment) reaches the market. In the war-stricken countries a number of factors added to this development - residual monetary inflation from the period of war and occupation; government deficits caused interalia by the social demands of the after-war period; distrust in the local currency and the like. After-war inflation was general all over the world, including the United States. But inflation in the United States did not cause that country to consume and invest beyond its productive capacity, In Latin America - generally speaking - consumption and investment exceeded productive capacity but the excess remained within the limits of the foreign reserves accumulated during the war. In Western Europe and a number of other areas consumption and investment exceeded productive capacity to an extent that surpassed available foreign reserves. It would be unjust to blame the latter group for this excess. There was no other way to put those countries back into a position where they could use their productive skill and experience so as to pay for a standard of living high enough to safeguard their traditional social structure. But it was bound to throw this cost and price structure out of line with the cost and price structure of the rest of the world at any rate as long as the comparison of the relative cost and price structures was based on the exchange rates prevailing in 1945. On the basis of those rates the balance of payments could therefore be kept in equilibrium only by trade and exchange restrictions and by extraordinary methods of financing like Marshall aid.

During the reconstruction period all this was unavoidable. But adjustment had to take place before a new balanced world economy could be striven at. Theoretically this adjustment could be brought about by deflationary methods. No doubt, such methods are necessary in any case. Beyond a certain point, however, they are, as we now allagree, socially and politically unacceptable and even economically unsuitable. For, though it is undeniably necessary that all countries should learn to live within their means - that is not to consume and invest beyond their productive capacity - it is as undeniable that that productive capacity itself should be developed as much as possible. And beyond a certain point, deflationary methods unfortunately tend to stymie such development. The solution therefore is a combination of deflation (or disinflation as the euphemism goes) and currency realignment.

Why, however, could not such currency realignment be postponed until the moment that at least the general outline of the future pattern of world production and trade had become clear to the eye?

The answer seems to me to be that without an alignment at this moment the adjustment of the world production to a future balanced pattern would have been a task too difficult to be realized. The adaptation of production and trade to a new world pattern is difficult enough <u>without</u> the obstacle of a distortion in the relative structure of costs and prices. The tension created by such distortion in the economic relations not only with the Western Hemisphere but also between the countries outside that Hemisphere themselves (and the restrictive measures necessitated by that tension) would have added so much strain to the effort of redirecting production and acquiring new outlets for its output that the task would in all likelihood have become unmanageable. This was becoming more and more clear now that in many parts of the world the time of the seller's market was coming to an end. It became clear to governments, to the people in business and trade and also, of course, to that elusive and undefinable creature, the speculator, whose capacity to anticipate future events still seems able to overcome the obstacles put in his way by governmental restrictions. While governments were considering their way of action, events were maturing under the influence of the same forces that shaped them in the days before exchange control existed: September 1949 was in many ways reminiscent of September 1931.

The realignment that has taken place is foremost a realignment of the sterling-dollar rate, with most other currencies keeping their rate of exchange with sterling unchanged. It is a readjustment by the soft currency group of its relation to the dollar with some adjustment for those nearly hard currencies like the Canadian dollar and the Belgian franc.

In judging the significance of this step towards establishing "appropriate rates of exchange" several aspects should not be overlooked. First, realignment of currencies alone does not bring about the adjustment of production and trade of which we spoke. It merely makes such adjustment feasible. Neither does the present realignment constitute the establishment of rates of exchange appropriate to the future pattern of world trade and production. It is not, in itself, enough to do away with the dollar gap or with whatever disequilibrium there is in the balance of payments outside the dollar area. If the new exchange rates are to be maintained, the adjustment of production and trade and, implicit, the relative structure of costs and prices will have to be shaped so as to make them "appropriate." Otherwise, a new alignment will have to take place at a later date.

Most governments consider a new realignment highly undesirable and in their choice of the percentage of devaluation they may therefore have gone rather far so as to have some margin. But if we want the now chosen rates of exchange to prevail in the foreseeable future it means that a very definite limitation is put on the freedom to indulge in inflationary policies influencing costs and prices.

You will ask me: where does the International Bank for Reconstruction and Development enter this picture?

The creation, at Bretton Woods, of the International Monetary Fund aimed at giving the world an international system of currencies freely convertible at stable rates of exchange. It is in the Bretton Woods Fund Agreement that one finds the concept of a "postwar transitional period" which we have been discussing today. During this period the countries who are members of the Fund are cooperating in order to help create the conditions under which the rules of monetary conduct embodied in the Fund Agreement can find general application. Needless to say, therefore, that the currency realignment that happened last month was of first concern to the International Monetary Fund. In devising the Monetary Fund, the Bretton Woods Founding Fathers realized that both during the transitional period and thereafter healthy monetary developments were dependent on the availability of long-term capital to finance international investment. It was to be expected, however, that during the transitional period such capital would not be available from private sources unless in some way private investors were protected against risks of a political character. But even in a more distant future international investment might not be available in sufficient amounts to make possible the development of less developed areas in the world. It was generally felt therefore that an international institution in which all nations cooperated, could have a strong beneficial influence in fostering and directing international investment. It was for those reasons that, as a twin sister to the International Monetary Fund, the International Bank was founded. The Bank was to channel private capital into international investment. Apart from its share capital, provided by the member countries, its resources were to come from the private investor, not from governments.

The Bank's role in reconstruction was certainly overestimated at Bretton Woods. The war-stricken countries needed more goods from abroad and especially from the dollar area than could have been financed by loans from the International Bank. Still the first loans from the Bank were reconstruction loans to France, Holland, Luxembourg and Denmark. Coming before Marshall aid they certainly fulfilled an essential function in the recovery of these countries. But the permanent task of the Bank lies in another field than reconstruction, namely in the field of development. The development of less developed areas in the world will be one of the most gratifying tasks of the Bank. It has already embarked on loans in this field, in Latin America and Asia and is studying projects in Africa. Development is a slow process demanding preparation and study and the rate at which the Bank will develop its activities in this field will be steady but slow. One should not think, however, that the Bank's activities will be limited to the development of underdeveloped areas. There is need for foreign investment all over the world. It would be rash to assume that enough capital for such investment will be available from private sources without special protection against non-commercial risks, even after the transitional period has come to an end after the economy of the world has found a new balance. In the long run, therefore, the Bank is faced with a world-wide task and its activity can be of inestimable benefit to a prosperous economic development in every corner of the globe.

I have taken so much of your time already that I will not go into detailed description of the Bank's financial structure, of its organization and its methods. I will, of course, be only too glad to answer any question you might like to ask about it.

I will end in thanking you for the opportunity you have given me to paint a picture of the monetary problems of the day. It is by no means easy to pierce the mist that clouds the real significance of events still so near to us. I found it a far from easy task to sketch a broad outline of those events. I will feel amply rewarded if my rough sketch has made a contribution to our mutual understanding of the problems that beset the relations between the New and the Old World.

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File Title	Barcode No.
Beyen, J. W. - Articles and Speeches (1946 - 1950)	1651313

Document Date	Document Type
26 June 1950	Board Record

Correspondents / Participants
J.W. Beyen to the Board

Subject / Title
Summary of Expose by J.W. Beyen at the Board meeting of June 23, 1950, on the E.P.U. plans and the problem of intraregional convertibility.

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