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A N N E X

to

Preliminary Report to Subcommittee
on Exchange Discrimination 1/

EXCHANGE DISCRIMINATION AND CURRENT PROPOSALS FOR
INTERNATIONAL MONETARY STABILIZATION

by

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1/ This memorandum has not yet been considered by the Subcommittee and is submitted in advance of such consideration with the idea of making available to the Trade Barriers Committee immediately, all pertinent data thus far assembled.

EXCHANGE DISCRIMINATION AND CURRENT PROPOSALS FOR
INTERNATIONAL MONETARY STABILIZATION

The need for stabilization of exchange rates.

Fluctuations in international exchange rates have long been recognized as serious barriers to the smooth flow of international trade. On the one hand exporters and importers, who are frequently not in a position to protect themselves by hedging operations, find their foreign transactions rendered more expensive because of the serious exchange risks involved in such fluctuations. On the other hand, speculation in foreign exchange is encouraged and only too frequently leads to the flight of capital, particularly in the form of banking funds, from one country to another.

Some of the causes of serious exchange rate fluctuations.

Exchange rate fluctuations may result from a considerable variety of causes. Some of these causes which have been prominent sources of fluctuation in the period since the first World War may be mentioned especially since there is reason to expect the recurrence of these causes after the present war, unless adequate preventive measures are instituted.

(1) A deflationary policy may be adopted by one or more countries in order to satisfy popular demands for a reduction in the cost of living or for other reasons. Current insistence upon a "roll-back" of certain prices shows that the lowering of prices still makes a strong appeal to certain classes who may appraise too lightly the possible depressing effects of such price reductions. Business groups engaged in the export trade may also contribute to the pressure for a deflationary policy believing that domestic costs must be lowered in order to permit the sale of goods abroad.

(2) Devaluation of domestic monetary units may be wilfully undertaken, either with the purpose of raising domestic prices, which are deemed to be undesirably low and thus lending to depressed business conditions, or with the desire to expand exports through cheapening the national monetary unit on foreign markets. The latter motive is particularly undesirable from the viewpoint of international relationships since it is likely to lead to efforts on the part of other countries to meet the new situation either by depreciation of their own currencies or by more direct trade-control devices such as the imposition of import quotas, clearing agreements, etc.

(3) The fiscal conditions in certain countries may bring about undesired declines in the values of their monetary units even though the governments may be endeavoring to check such declines by customary measures of price control, taxation, etc.

(4) During the present war, as during the first World War, foreign exchange transactions between many countries have disappeared completely and between others the existing rates of exchange, largely confined to inter-governmental transactions, have become more and more out of line with the underlying economic conditions. The decisions which have to be made some time after the cessation of hostilities as to the desired or appropriate rates of exchange between the various countries are only too likely to be more affected by a consideration of traditional factors than by a rational weighing of the currently applicable data; moreover, even the most intelligent and unbiased decisions on the basis of current fragmentary information may prove badly suited to the actual conditions.

(5) Regardless of their causes, business depressions in industrial countries tend to produce balance of payments difficulties for those countries whose exports consist largely of raw materials and food products.

The role of post-war exchange stabilization plans.

The proposals for post-war international monetary stabilization represent attempts to lessen the evils of fluctuating exchange rates through the medium of international cooperation. The proposals call for the establishment of an international institution, a Fund or a Union, to which will be entrusted certain powers, resources and responsibilities, to facilitate this international cooperation.

Removal of exchange discriminations.

Incidental to the primary purpose of exchange rate stabilization as a means of improving international trade relations is the removal of exchange rate discriminations. The proposals may help to eliminate foreign exchange discriminations in various ways:

(1) The desire to utilize discriminatory exchange practices may be lessened by establishing a multilateral clearing arrangement which will stable buyers in each country to choose freely the foreign country in which to buy, without regard to the national location of the markets for the export goods of their countries.

(2) The Fund, or the Union, may extend a form of international short-term credit which will be useful in preventing temporary excesses of exports or imports from causing wide fluctuation in exchange rates. Although these operations appear in some sense to have a credit character, it is expected that importers will make payments no less promptly than usual in terms of their own currency and thus will receive no credit from the Fund or Union.

(3) Perhaps the most effective contribution to the removal of exchange discrimination will come from the close association and consultation of the representatives of the member countries on monetary problems as they arise.

(4) Specifically the proposal may stipulate the acceptances of an international agreement to abandon or to refrain from precisely defined discriminatory foreign exchange practices.

The most pertinent sections of the Treasury proposal for a United and Associated Nations Stabilization Fund and the British plan for an International Clearing Union are as follows:

PROPOSAL FOR A UNITED AND ASSOCIATED NATIONS
STABILIZATION FUND

Preamble

1. We must assure a troubled world that the free countries will solve these perplexing problems, and that they will not resort to competitive exchange depreciation, multiple currency practices, discriminatory bilateral clearing, or other destructive foreign exchange devices.

4. The Fund is intended to provide supplemental facilities for the successful functioning of the established foreign exchange institutions and to free international commerce from harmful restrictions.

I. Purposes of the Fund

5. To reduce the use of such foreign exchange restrictions, bilateral exchange clearing arrangement, multiple currency devices, and discriminatory foreign exchange practices as hamper world trade and the international flow of productive capital.

VII. Policies of Member Countries

2. To abandon, as soon as the member country decides that conditions permit, all restrictions (other than those involving capital transfers) over foreign exchange transactions with other member countries, and not to impose any additional restrictions (except upon capital transfers) without the approval of the Fund.

The Fund may make representations to member countries that conditions are favorable for the abandonment of restrictions over foreign exchange transactions, and each member country shall give consideration to such representations.

All member countries agree that all of the local currency holdings of the Fund shall be free from any restrictions as to their use. This provision does not apply to blocked foreign balances acquired by the Fund.

5. Not to enter upon any new bilateral foreign exchange clearing arrangements, nor engage in multiple currency practices, which in the judgment of the Fund would retard the growth of world trade or the international flow of productive capital.

PROPOSALS FOR AN INTERNATIONAL CLEARING UNION

I. The Objects of the Plan

(a) We need an instrument of international currency having general acceptability between nations, so that blocked balances and bilateral clearings are unnecessary; that is to say, an instrument of currency used by each nation in its transactions with other nations, operating through whatever national organ, such as a Treasury or a Central Bank, is most appropriate, private individuals, businesses and banks other than Central Banks, each continuing to use their own national currency as heretofore.

(b) We need an orderly and agreed method of determining the relative exchange values of national currency units, so that unilateral action and competitive exchange depreciations are prevented.

(g) More generally, we need a means of reassurance to a troubled world, by which any country whose own affairs are conducted with due prudence is relieved of anxiety, for causes which are not of its own making, concerning its ability to meet its international liabilities; and which will, therefore, make unnecessary those methods of restriction and discrimination which countries have adopted hitherto, not on their merits, but as measures of self-protection from disruptive outside forces.

II. Provisions of the Plan

6. (3) The member States will agree between themselves the initial values of their own currencies in terms of bancor. A member State may not subsequently alter the value of its currency in terms of bancor without the permission of the Governing Board except under the conditions stated below; but during the first five years after the inception of the system the Governing Board shall give special consideration to appeals for an adjustment in the exchange value of a national currency unit on the ground of unforeseen circumstances.

(4) The value of bancor in terms of gold shall be fixed by the Governing Board. Member States shall not purchase or acquire gold, directly or indirectly, at a price in terms of their national currencies in excess of the parity which corresponds to the value of their currency in terms of bancor and to the value of bancor in terms of gold. Their sales and purchases of gold shall not be otherwise restricted.

IV. Some Advantages of the Plan

14. It should be much easier, and surely more satisfactory for all of us, to enter into a general and collective responsibility, applying to all countries alike, that a country finding itself in a creditor position against the rest of the world as a whole should enter into an arrangement not to allow this credit balance to exercise a contractionist pressure against world economy and, by repercussion, against the economy of the creditor country itself. This would give everyone the great assistance of multilateral clearing, whereby (for example) Great Britain could offset favourable balances arising out of her exports to Europe against unfavourable balances due to the United States or South America or elsewhere. How, indeed, can any country hope to start up trade with Europe during the relief and reconstruction period on any other terms?

V. THE DAILY MANAGEMENT OF THE EXCHANGES UNDER THE PLAN

19. The Clearing Union restores unfettered multilateral clearing between its members. Compare this with the difficulties and complications of a large number of bilateral agreements. Compare, above all, the provisions by which a country, taking improper advantage of a payments agreement (for the system is, in fact, a generalized payments agreement), as Germany did before the war, is dealt with not by a single country (which may not be strong enough to act effectively in isolation or cannot afford to incur the diplomatic odium of isolated action), but by the system as a whole. If the argument is used that the Clearing Union may have difficulty in disciplining a misbehaving country and in avoiding consequential loss, with what much greater force can we urge this objection against a multiplicity of separate bilateral payments agreements.

21. The principles governing transactions are: first, that the Clearing Union is set up, not for the transaction of daily business between individual traders or banks, but for the clearing and settlement of the ultimate outstanding balances between Central Banks (and certain other super-national Institutions), such as would have been settled under the old gold standard by the shipment or the earmarking of gold, and should not trespass unnecessarily beyond this field; and, second, that its purpose is to increase freedom in international commerce and not to multiply interferences or compulsions.

22. Many Central Banks have found great advantage in centralizing with themselves or with an Exchange Control the supply and demand of all foreign exchange, thus dispensing with an outside exchange market, though continuing to accommodate individuals through the existing banks and not directly. The further extension of such arrangements would be consonant with the general purposes of the Clearing Union, inasmuch as they would promote order and discipline in international exchange transactions in detail as well as in general. The same is true of the control of capital movements, further described below, which many States are likely to wish to impose on their own nationals. But the structure of the proposed Clearing Union does not require such measures of centralization or of control on the part of a member State. It is, for example, consistent alike with the type of Exchange Control now established in the United Kingdom or with the system now operating in the United States. The Union does not prevent private holdings of foreign currency or private dealings in exchange or international capital movements, if these have been approved or allowed by the member States concerned. Central Banks can deal direct with one another as heretofore. No transaction in bancor will take place except when a member State or its Central Bank is exercising the right to pay in it. In no case is there any direct control on capital movements by the Union, even in the case of 6 (8) (b) (ii) above, but only by the member States themselves through their own institutions. Thus the fabric of international banking organization, built up by long experience to satisfy practical needs, would be left as undisturbed as possible.

VIII. RELATION OF THE CLEARING UNION TO COMMERCIAL POLICY

37. The special protective expedients which were developed between the two wars were sometimes due to political, social or industrial reasons. But frequently they were nothing more than forced and undesired dodges to protect an unbalanced position of a country's overseas payments. The new system, by helping to provide a register of the size and whereabouts of the aggregate debtor and creditor positions respectively, and an indication whether it is reasonable for a particular country to adopt special expedients as a temporary measure to assist in regaining equilibrium in its balance of payments, would make it possible to establish a general rule not to adopt them, subject to the indicated exceptions.

Summary

The general tenor of exchange stabilization proposals now under consideration is favourable to the gradual elimination of exchange restrictions and discriminations to the extent that they may be held to be detrimental to international trade. The complete and immediate removal of such devices has not been made a condition for membership in the proposed international organizations. It is hoped and expected that successful operation of the new international organization will make member nations willing to abandon these and other undesirable exchange practices.

S. D. Southworth