F-2(4)

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PROPOSAL FOR STABILIZATION FUND AND RECONSTRUCTION BANK

(dated April 1942, H. D. W.)

1. The Importance of the Problems Raised and Difficulty of Solution.

It is extremely significant that a proposal for a stabilization fund and Bank for Reconstruction is available for discussion. Out of efforts to develop concrete and carefully elaborated plans such as these can come workable schemes for a better economic and political world. It is difficult to exaggerate the potential importance of efforts of this sort. They are not Utopian, for some of these functions are absolute essentials for the postwar period. They are not impossible of execution because some lesser attempts have already been tried, supported by much less determination to make them a success. They will call for the most thoughtful and judicious development, however, with many months of conference with a reasonable willingness to reconcile a number of basic conflicts of interests. Clearly success will depend on willingness of the United States to follow through on fairly large reconstruction plans. Obviously the interests of some business concerns will suffer, at least in the short fun. Similarly, governments will have to modify their freedom of action in the financial sphere if any substantial progress is to be made.

2. General Comments may be Most Useful Now.

There is some question as to the kind of comments most helpful at this stage. Questions and criticism as to detail could be directed to many separate points. Some of these can be cleared up by a careful reworking of competent experts with various points of view. It is probably not wise to list all these particular queries or criticisms now. In any case, a re-reading and careful examination of the interrelations of different parts of the plan would be necessary.

In this further consideration, the differences between the functions of the two institutions must be paramount. There are some questions which can be raised now about the two proposals in combination, and the ideas which are common to both.

3. Questions Regarding the Combined Scheme.

a) Are the arguments for attempting to separate the two institutions valid?

The arguments given in the document are not convincing on this point. While the technical proficiencies required are different, the same general point of view and competence would be required of the higher technicians and managers of both.

(3. Questions Regarding the Combined Scheme - Continued)

Clearly, the two have to be carefully coordinated in policy, in timing of operations, in political and economic aims.

The demands on the capacities and resources, both in personnel and in funds, will hardly be adequate for the two undertakings. Surely some economy from joint operations and management can be achieved.

If the two institutions are in the same locality it is inevitable that they will draw together closely and so become more unified in fact than is provided in the plan, or they will move apart and develop unhealthy rivalries.

The possibilities of separating the transactions under one management are various. Trustee relations can be established which will afford special protection to the fund.

The problem of withdrawal from the bank and not from the fund might hamper operations.

Furthermore, it does not seem clear to what extent the separate entities have been suggested forpolitical, as contrasted with economic, reasons. Is there an attempt to increase the likelihood of some action by making two separate efforts, with the hope of gaining at least a part of the plan? Certainly, there will be some confusion in the minds of the public and of the legislative godies in the different countries as to the relationships of the two efforts and the separation of functions.

b) Membership in the two institutions. (See pp. II, 49-60).

Is it possible to operate them on a sound basis without including on some carefully planned basis some of the invaded, neutral and enemy countries?

If, then, these must be included, should the group be made up initially of countries with foreign trade and exchange of considerable volume, with the less active and smaller countries gradually brought in later?

The answers to these questions clearly depend on the situation of various nations at the close of the war, but the need for reconstruction and stabilisation will probably be most urgently needed for some of the territories now under enemy domination.

The eligibility conditions represent a list of important considerations but they are very far-reaching, particularly those concerned with trade and prices. They would exclude at the start, or eliminate later, some of the countries most needed in the institutions.

c) The Role Assigned to the United States.

Clearly the United States would supply under this plan the largest amount of capital put up by any country and would have more votes than any other country. The extent to which her role would surpass that of the other countries is somewhat obscured in the discussion and does not show up in dramatic form in the tables.

While there might, at first thought, seem to be advantages in this situation, the dangers are very real.

There is, first, the question of convincing American legislators of accepting this highly responsible--even dominating--position in international finance.

There is, second, the probability that the outstanding power will lead to the development of blocs to outvote and outmaneuver the single country which has so much potential influence.

There is, third, the experience of recent years that creditor countries soon lose their real power over those with less wealth and capacity, and have to keep supportint those whose withdrawal from the enterprise would threaten the whole effort.

d) There are a number of difficult questions with regard to cooperation, discipline, control and management.

It is assumed that most countries will want to adhere to the scheme; is this a fair assumption; are the inducements sufficient?

Would expulsion be a punishment to the offender, or might it offer a real, though destructive, power to the member who would break the rules and withdraw suddenly with full knowledge of the financial conditions and plans of Fund and Bank?

The voting arrangements are somewhat complex. Is it contemplated that representatives of twenty governments would vote on separate transactions, changes in rates of exchange or interest, or other similar matters? Would it not rather be preferable to have general principles laid down in advance, and review periodically, the various activities, say quarterly, with instructions of a broad general character guiding the operating staff?

Where delicate financial operations are concerned, only those individuals most closely concerned can know of separate transactions in advance without inducing speculation and giving opportunity for profit by outsiders through knowledge of what is planned. The documents show an awareness of the problem, but do not indicate a delegation of functions which would seem consistent with the sensitive nature of exchange transactions.

e) The causes of economic disequilibrium and persistent one-way movements of funds are not adequately taken into account. For example:

Can the pound sterling be stabilized and freer exchange relations be established unless economic concessions and political conditions favor a steady prolonged expansion of British exports?

Can stability be achieved unless the United States is willing to receive large imports?

Can equilibrium between countries with different natural resources, efficiency, and density of population, be maintained without permitting different costs of production to be reflected in their ability to produce and market goods at lower prices?

Can American gold be redistributed without sacrificing national interests beyond the point acceptable to the American people?

Serious questions are raised by the statement that fundamental changes in exchange rates are to be allowed to take place. Until this is defined and explained, it is hard to discuss the economics of the scheme.

Participation on the basis of national income raises political, administrative, and economic questions.

The answer to these and other similar questions will depend on basic economic and political factors.

4. The Fund (II. pp. 1-10a).

I. Purposes:

1. Stabilize exchanges.
2. Encourage capital flow.
3. Liberate blocked balances.
4. Correct maldistribution of gold.
5. Service debts.
6. Shorten periods of disequilibrium.
7. Reduce necessity of exchange controls.
8. Eliminate diversity of agreements and currencies practice.
9. Promote sound money and credit.
10. Reduce trade barriers.
11. Promote more efficient clearing.

Topics 1, 3, 5, 7, and 11 are clearly topics closely related to each other and appropriate to carry on within one administrative organization.

Topics 2, 4, 6, 8, 9, and 10 go further. Most of them call for extensive action in extending short- and long-term credit and in re-shaping economic institutions. The question arises--do they not more properly come under the control of an international bank?

II. Powers. (I. 2-6).

Including the purchase and sale of gold, currencies, securities, bills of exchange, etc., lending to separate countries, fixing exchange rates. Without the consent of the country, the fund can't do business within a country and must deal with treasury or designated bank.

These are extensive and adequate; some might not be necessary to more central purposes--for instance, the permission to purchase government bonds might be questioned. (Details as to transactions will be reviewed further in another memorandum).

III. Membership: (I. 7, 8).

Members of the United and Associated Nations under specified conditions.

The conditions are good but may be difficult to enforce. For example, the statement regarding the non-adoption of monetary and general price measures is too broad, the same might be said of the condition regarding export subsidies which take various forms.

The conditions might be so restrictive as to exclude important nations. Similarly, if complied with, they would render safe the inclusion of enemy nations.

IV. Composition: (I. S.)

Gold, currencies, securities, up to a total of at least 5 billion dollars, 50% paid up, the rest in installments. The Bank shall subscribe 100 million dollars to the fund.

V. Management:

A Board of Directors consisting of representatives appointed by member governments. The Board elects a chairman; the representatives vote on a number of questions.

A general comment applies to this part of the plan (see above introductory remarks). Representatives of governments have to speak for the interests of their national administrations, they would have to be replaced as governments were changed. Technical exchange transactions, or economic policies, in the international sphere cannot be mainly dependent on this sort of management. The powers must be delegated and authority reasonably continuous or the whole plan will fail.

In the case of the Bank for International Settlements, whenever there was division along political lines, however legitimate the position of the different nations, it always delayed or prevented action even though the members' governing bodies were never in theory and not always in fact responsible to the separate governments but represented the Central Banks.

VI. Rules and regulations "promulgated by four-fifths of the member votes."

VII. "No change in the gold value of any currency of the participating countries shall be permitted to alter the gold value of the total currency holdings in the Fund."

The implementation of this provision would be difficult.

VIII. Countries failing to contribute shall be dropped and shall have returned its contribution minus sum due.

IX. Profits to be distributed annually.

X. Information to be furnished the fund.

General comments on the fund:

Presumably the technical operations are clearly envisaged but they will be examined more closely, particularly the unfreezing of balances.

The dropping of a member may not always be a punishment.

The time periods for repayment, etc. (II. 26) seem too long.

The purchase and sale of government securities may be inadvisable.

Membership, administrative authority, and location are all important.

Some limitations on sovereign rights are contemplated and would have to be a part of the scheme.

The responsibility on the United States would be very large.

5. The Bank. (I, 11-20).

I. Objectives: (I, 11, 12).

1. Provide capital.
2. Facilitate transition to peace economy.
3. Finance foreign trade.
4. Strengthen money and credit by redistributing gold.
5. Eliminate the dangers of world crises and shorten depressions.
6. Help stabilize prices of important raw materials.
7. Increase production and raise standards of living.
8. Promote cooperation.
9. Make the solution of peace conference problems easier.
10. Enhance democracy.
11. Aid relief financing.
12. Promote equitable access to raw materials.

II. Powers: (I. 12-16).

1. Loans (see detail of varied types; see also points 4, 5, 6, 7.)

2. Guarantee loans.
e. Issue notes against government obligations on gold.
4 - 5 - 6 - 7. Also concerned with loans.
8. Organize an International Essential Raw Material Development Corporation. (I. 14).
9. Organize a commodity stabilization corporation. (I. 15).
10. To buy and sell gold, securities, and to clear funds, balances, checks, drafts, acceptances.
11. Discount and re-discount bills acceptances, and obligations.
12. To act as agents for governments and banks.
13. To re-discount Central Bank bills.
14. To issue and sell debentures.
15. Deal only with:
    - (a) governments of members, and
    - (b) with central banks or fiscal agents of those countries with consent of their finance ministers,
    - (c) with stabilization fund,
    - (d) or any international bank owned by some of member banks.
16. Engage in studies.

The powers of the Bank are immense. If a majority of the Board wished to use them, they could bring on a crisis or stimulate inflation, or break in all but a few of the more powerful economies, any business interests, any currency relations. Since large-scale inflation by currency issue, lending, and regulations of values and rates of exchange are possible, deflation by stopping or reversing the process is also possible. Various checks on deflation can be devised without paralyzing the functions of the Bank. Limits to amounts of loans, specification as to purposes of enterprises aided, types of borrowers, the currency relations established, and so on, can place limits. For example, for reasons that cannot be fully explained here, deposits in the Bank for International Settlements made by country A were held in a currency and Central Bank other than A's.

Is point 15 meant to condition all the other points? If so, the exclusion of many neutral and enemy powers, the voluntary withdrawal from the Bank may cripple its activities.

III. Capital structure. (I. 16).

Ten billion dollars in 10,000 shares, 50% paid up, the rest callable, shares non-transferable.

Voting linked with shares with a maximum of 25% to any one country (actually applicable to the United States.)

(See further detail).

IV. Membership. (I. 17. See Fund).

a) A member of stabilization fund.
b) At peace.

V. Management. (I. 18).

The Board consists of one representative and one alternate appointed by each government. Board selects President and sets up departments, appoints executive committee, appoints advisory committee.

Decisions by simple majority of votes cast.

Board must approve granting of intermediate and long term credit, etc.

VI. Profits. (I, 20).

25% to surplus, etc., paid in local currency or gold, recorded in "New International Units". (Dividends not limited).

VII. If a member withdraws, stock can be repurchased by the Bank.

General Comments.

1. There is no discussion of the potentialities for inflation or deflation.

2. Nothing is said regarding location which has an extremely important bearing on the nature of the plan and the sphere of influence.

3. The discussion of the new international Unit of account is not adequate to form a basis for comment. The suggestion is wide in its implications.

4. Relations to non-member countries are not fully taken into account.

5. Special links with Central Banks should be provided in addition to links with the Treasury Department.

6. It is essential to provide for continuity of operating officials such that changes in the Board of Directors cannot bring a clean sweep of technical and operating personnel. The main struggles will be political; the main accomplishments should be economic.

7. Interest rate policy must be more fully discussed and can exert a major influence on success or failure.

8. The location of gold holdings is not considered as serious a question as it may in fact become.

9. Raw materials. Corporation should be separate.

Failure to make any reference either to the good or bad devices worked out by the Bank for International Settlements (and other financial international institutions) is so conspicuous as to raise questions as to why. For example, the limitation of dividends seems obvious and the whole policy on profit could be guided by the Bank's experience.

Also the relation of the Board of Directors to resident managers, and their relations to technicians and outside groups, could be the basis for similarities and differences.

It is probably not worth exploring the detail much further until conversations have helped clarify the above queries. The whole document will be reviewed, however, to check on the validity of first impressions and to look for other critical provisions.

Clearly there is something to work on and if there is opportunity for real criticism and many modifications urgently needed, instrumentalities for economic progress and world peace may result.