Confidential

For limited circulation

AMERICAN INTERESTS IN THE WAR AND THE PEACE

International Monetary and Financial Programs

COUNCIL ON FOREIGN RELATIONS

New York

OFFICE
SECRETARY OF TREASURY
1944 FEB 18 AM 7 54
3:40

OFFICE
SECRETARY OF TREASURY
1944 FEB 18 AM 7 54

AMERICAN INTERESTS IN THE WAR AND THE PEACE

A program of Studies organized by the Council on Foreign Relations has resulted in the preparation of a number of memoranda which seem of sufficient value to deserve circulation to selected individuals. The views expressed in these memoranda are not those of the Council, which under its established practice does not take a position on public questions.

•

Steering Committee

NORMAN H. DAVIS
Chairman

HAMILTON FISH ARMSTRONG
Vice-Chairman

WALTER H. MALLORY
Secretary

JULIUS W. PRATT
Administrative Secretary

HANSON W. BALDWIN
ISAIAH BOWMAN
CARTER GOODRICH
ALVIN H. HANSEN
JACOB VINER
EDWARD P. WARNER
HENRY M. WRISTON

•

Group on Economic and Financial Questions

ALVIN H. HANSEN
JACOB VINER
Joint-Rapporteurs

ARTHUR D. GAYER
Research Secretary

PERCY W. BIDWELL
EDWIN F. CHINLUND
BENJAMIN V. COHEN
WILLIAM DIEBOLD, JR.
RALPH E. FLANDERS
WINFIELD W. RIEFLER
WILLIAM H. SCHUBART
ALLAN SPROUL
EUGENE STALEY
ARTHUR R. UPGREN

•

COUNCIL ON FOREIGN RELATIONS
45 EAST 65TH STREET, NEW YORK 21

February, 1944

INTERNATIONAL MONETARY AND FINANCIAL PROGRAMS

Prepared by Alvin H. Hansen

World Instability, 1919-1939

The world as a whole failed miserably to make the economy function in a satisfactory manner in the two decades between the two World Wars. For this the great industrial nations which control the bulk of the world's resources are mainly to blame. By failing to make adequate use of their own resources in the interest of their own people, economic distress spread to the countries less adequately endowed with natural resources. Out of this failure sprang the breakdown of the world economy and indeed of international political security.

Between the two World Wars, we suffered, throughout the Western world with varying degrees in different countries, violent price fluctuations, catastrophic movements in the level of employment, prolonged intervals of mass unemployment in all the major industrial countries, and very serious undermining of property values leading in some countries to widespread bankruptcy and in others to a virtual elimination of the middle class.

We shall not succeed in establishing a secure political world following this war unless we solve our economic problems. High levels of employment and a high degree of economic stability underlie basically all programs of international relations. Unless these economic ends are achieved, any United Nations program along political lines will utterly fail. It would be suicidal to assume that these economic ends can be expected to be reached by letting things take their course.

Accordingly, there is a growing belief throughout the world that a number of new international economic institutions must be undertaken, and that all nations must earnestly cooperate to secure enlightened management of these institutions so that they may contribute to the desired economic goals of stability and full employment.

International Monetary Problems

That international monetary relations had reached a serious impasse by September 1939 is fully evident from the growth of bilateralism, clearing agreements, and foreign exchange control.

The reconstruction of a free exchange system will obviously encounter serious obstacles. To begin with, there is the current maldistribution of international monetary reserves evidenced by the fact that the United States now holds $23 billion of gold, two-thirds of the world's supply of monetary gold. It is true that the abnormal holdings by the

United States do not necessarily imply that foreign countries are possessed of insufficient reserves to operate a free exchange system. Foreign countries outside of the United States and Russia hold \$9½ billion of gold which exceeds the total gold (dollar value) held by all countries in the world in 1925. Moreover, new gold production is now enormously greater than in the 'twenties and this also must be taken into account. The gold holdings of foreign countries are, however, not well distributed among the different countries nor do all countries participate at all equally in the new gold production. It is also true that the abnormal gold inflow into the United States in the 'thirties was related not solely or even mainly to a world disequilibrium in the current international account but largely to capital movements. Thus, of the \$16 billion gold inflow (1934-1942), \$6 billion may be attributable to an export surplus (heavy in the years 1939, 1940, and 1941), while the remaining \$10 billion are attributable either to recorded capital inflow (\$6 billion) or to unidentified transactions (\$4 billion). Of the capital inflow, about \$2 billion represents return of American capital, about \$½ billion foreign purchase of American securities, and about \$1½ billion increased balances of central banks and governments in the United States. A considerable amount of the capital inflow clearly represents "hot money," and the whole is more or less related to disturbed political conditions. Thus, factors other than the "chronic world shortage of dollars" have been responsible for the larger part of the heavy gold inflow into the United States.

World Shortage of Dollars

But apart from the political and other factors, the United States has tended over many years to drain a disproportionate share of the world's gold owing to underlying economic factors affecting its current international account.

Related to this chronic disequilibrium is the long-run tendency through several decades of the terms of trade (i.e., the ratio of export prices to import prices) to move against the agricultural and raw material countries. This tendency, basically resting upon the relatively inelastic demand for most agricultural products, coupled with the increasing diversification of consumption and higher standards of living in the advanced countries, has caused the demand for agricultural products to fall in relation to that for industrial products. A rapidly developing agricultural technique (increasing agricultural efficiency and productivity) confronted by an inelastic demand schedule compels either serious deterioration of the terms of trade for these countries or emigration of their population or their transfer into industry in their own country. The net effect in fact has been partly deterioration of the terms of trade and partly an accentuation of industrialization.

The drastic redistribution of international assets (Germany in the last war and England in World War II) accentuates the international disequilibrium. Britain having largely lost her net creditor position and having suffered a substantial deterioration in her exports must, nevertheless, import foodstuffs and raw materials to prevent a decline in her standard of living. Britain is, moreover, unable to compete with the United States in just those products in greatest demand as living standards rise--automobiles, radios, phonographs, typewriters, electrical appliances, and the like. The technical superiority of the United States, the unfavorable terms of trade in the agricultural and raw materials countries, and the drastic redistribution of international assets combine to create a continued disequilibrium in world trade.

Dollar Appreciation as a Remedy

The appreciation of the dollar in relation to foreign currencies by itself alone would not prove very effective in achieving international equilibrium. This does not mean that exchange rate adjustment is of no importance as a means to promote international equilibrium but rather that it operates, unless combined with other equilibrating policies, within fairly restricted limits and in uncertain and unpredictable ways. Appreciation of the dollar is not very effective if the price elasticity of demand for foreign goods in the United States is less than unity, or if foreign countries are highly dependent upon imports of foodstuffs and raw materials (as in the case of England) or upon machinery and highly finished industrial products (as in many undeveloped countries). Thus a rise in the foreign exchange value of the dollar may have little effect on the <u>quantity</u> of imports into the United States and may indeed even lower the dollar <u>value</u> of total imports, while on the other hand it will not materially decrease the physical volume of United States exports, especially in the important range of industrial commodities in which the United States has a wide margin of competitive advantage. Moreover, exchange appreciation may simply be offset by <u>deflation</u> of prices in the United States, so that a change in rates may fail to change the competitive price situation of United States imports or United States exports, and thus fail to increase imports or to deter exports. Thus when the pound sterling fell from 1931 to 1933, price deflation in the United States accompanied the appreciation of the dollar. The current account balance continued favorable, though the magnitude of the active balance did decline. Moreover, account should be taken of the fact that appreciation of the dollar would increase the burden of debt (contracted in dollar terms) of foreign countries to the United States.

This leads to the conclusion that adjustment must be sought mainly along other lines. If, however, these other steps are taken, exchange adjustment can play an important though secondary role in the achievement of international equilibrium.

Means of Achieving Equilibrium

The main means to achieve international equilibrium are: (a) the promotion of full employment in the industrially mature countries, and especially in the United States; (b) the development of industrialization of the backward countries designed to change the structure of their economies; and (c) tariff reduction in the United States.

International collaboration to secure full employment in the industrially mature countries promotes international equilibrium in the respect that a full-employment income in these countries tends to spread prosperity throughout the world and in general promotes a high level of world trade. Within the framework of full employment and a high level of world trade substantial tariff reductions in the mature countries become feasible, and price adjustments incident to changes in the United States tariffs and in United States exchange rates can be more effective than is possible under conditions of under-employment.

A structural change in the economies of undeveloped countries is equally important. This means diversification of agriculture, better equipment in farms, mechanization of agricultural production, improved transportation facilities, electrification, and the spread of industrialization. Industrialization is typically possible along the following lines: (a) the first stages in the processing of indigenous raw materials, (b) the development of lighter consumers' goods industries, and (c) the assembling of complicated industrial products manufactured abroad. Diversification and industrialization, moreover, require the promotion of large-scale developmental projects, including electric power, port facilities, river valley development, roads, railroads, airways, and other communications. Thus the basic solution runs in terms of the spread of capital equipment and modern techniques throughout the world.

In order to effectuate these two main programs of adjustment it will be necessary to set up international institutions which will be concerned (a) with counter-cyclical policy and the maintenance of substantially full employment, and (b) with the development and industrialization of backward areas.

International Institutions Designed to Furnish Stability and Expansion

In order to implement both the cyclical and the long-run development program the following major institutions for international collaboration are suggested: an International Development and Investment Bank, an International Clearing Union or Exchange Fund, an International Commodity Corporation. The close integration of the three institutions--the Bank, the Union (or Fund), and the Corporation--might be implemented by one director from each, together with an independent chairman, constituting an International Economic Board. Through this International Economic Board the operations of the three institutions could be integrated with internal expansionist programs in the various countries designed to counter depressional or inflationary tendencies and to promote full employment. Other international economic agencies, for example, an International Trade Commission,* may also prove desirable.

---

* For suggestions for the creation of an International Trade Commission see an earlier report in this series, Postwar Agreements on Commercial Policy, prepared by Percy W. Bidwell.

productivity and yield but also the social implications with respect to standards of living, economic diversification, urbanization, and the like. The productivity aspects of these developmental projects should be considered broadly in terms of the impact on the whole social structure, including induced private investment outlets, the increased productivity of subsidiary industries, increased employment, and real income.

National Development Authorities should be organized in each country or area in which developmental projects are undertaken. Thus, for example, there would be organized a Chinese Development Authority, a Brazilian Development Authority, etc.

Taking China as an illustration, there might be organized, let us say, half-a-dozen large developmental projects in that country. For each of these projects there would be organized an authority, for example, the Yangtse River Valley Authority. The stock of the Yangtse River Valley Authority in turn would be owned jointly by the International Development and Investment Bank and the Chinese Development Authority. Thus the International Development and Investment Bank would exercise joint control with the Chinese Development Authority over each development project and would furnish its due proportion of capital, management, and technical skill.

There would remain ample room for purely private projects. Some of these would be suitable for Chinese corporations and business firms; others would be suitable for foreign private corporations. The foreign corporations should be subject to the labor regulations of the country in which they are operating as well as to a special supervisory international agency designed to regularize the conduct of private corporations in foreign countries. Both the beneficiary government and the international supervisory agency might utilize the facilities of the International Labor Office in the development of suitable labor standards.

Private funds could be encouraged to go into foreign loans and investment by two types of procedures with which we are already more or less familiar in the experience which we have had with the Federal Housing Administration. As is well known, the Federal Housing Administration has proved an extremely effective instrument in directing the private investment funds of financial institutions such as life insurance companies, saving banks, and commercial banks into the private house mortgage field. Under the provisions of the FHA plan, the prospective individual home owners who are contemplating building a new house must supply 10 to 20 per cent of the total investment as equity money and the remaining part may be financed by mortgages insured and guaranteed by the FHA. The prospective owner engages to pay an arranged rate of interest plus a service charge including an insurance premium. These insurance premium payments are pooled by the FHA and serve as a first buffer guarantee of the mortgages held by the lending institutions. In the final analysis, if this insurance pool should be exhausted in a serious deflation of the real estate market, the Federal Treasury engages to guarantee the mortgages. The owner of the mortgage is, however, required in the first instance to foreclose on the property, and only in the event that such foreclosure does not adequately protect his mortgage will the insurance and guarantee be utilized.

A similar procedure could be used in the international lending field. The International Development and Investment Bank could similarly insure and guarantee the various loans, charging an insurance premium together with a service charge in addition to the rate of interest from the borrower. Such a program would go far to reassure confidence in foreign financial investment.

In addition, provision should also be made for the encouragement of equity investment. In the case of the FHA, it has been suggested that with respect to large apartment-house projects, the FHA might well offer a yield insurance on this entire investment. In this case there would be no mortgages whatever. A life insurance company, for example, would undertake a large apartment-house project and the FHA would be authorized to insure the recovery of substantially all of the original investment and a minimum annual return of, say, 2 per cent for a period, of, say, thirty years. Such a provision would offer a strong incentive to undertake large projects of this character. The life insurance company would, of course, anticipate and reasonably expect a return of perhaps 4 or $4\frac{1}{2}$ per cent, but it might not feel inclined to undertake the venture at all without a minimum guarantee. Similarly, in the international field equity capital could be induced to undertake large projects if a minimum guarantee were assured.

The International Development and Investment Bank would, however, if foreign investment is to be undertaken on an adequate scale, itself undertake to make loans and participate in direct investment. Such loans and participations would be made for approved projects whether undertaken by foreign governments or by private industry in foreign countries and which would be guaranteed by the government in question.

The funds thus provided by the International Development and Investment Bank could be raised in two ways. In considerable measure doubtless the Bank would be in a position to issue guaranteed bonds in the various private capital markets of the world. A second source would be the Bank's own capital funds subscribed by the various participating governments. The question may well be asked why there is any need for anything further than the insurance of private investment funds. The answer is that loans and investment by the Bank are necessary because many projects which deserve development cannot in fact provide advance assurance that they will earn sufficient returns to induce private investment. It does not follow that such development projects are, therefore, economically unsound. In the first place, it may be that certain basic development projects requiring a vast amount of fixed capital, such as electric power, river valley development, port facilities, and transportation facilities of different kinds cannot be undertaken unless funds can be obtained at a very low rate of interest. The Bank could sell guaranteed bonds in the private capital markets at lower rates of interest than would be possible in the case of private issues. Loans and investments which are feasible at a low rate of interest, therefore, could be financed by the device of guaranteed bonds of the International Development and Investment Bank.

In addition, however, it is important to recognize that there are many basic development projects which, viewed from the standpoint of their effect upon the economy as a whole, are profitable and thoroughly sound from the economic standpoint even though they cannot return the principal plus the government rate of interest, and may even be sound although they do not return the whole of the initial principal with no interest at all.

The foreign government, it is true, stands to gain in the first instance from the indirect repercussions upon its own national economy from these basic developments. It is, therefore, true that the foreign government should be able in most instances to guarantee the principal and a moderate rate of interest even though the direct returns to that government from the investment will be less than one hundred cents on the dollar. While this is true, it must not be overlooked that the International Development and Investment Bank might well share some of the loss of principal and interest with the foreign government in question. This follows from the fact that the member countries participating in the International Development and Investment Bank will indirectly benefit from these projects through the export stimulus which the foreign investment will provide. Particularly would this be the case in the event that such loans and investments were made in depression periods.

Bonds issued by the International Development and Investment Bank and guaranteed by the foreign borrowing country would, of course, be secured, in the event of default of the foreign country, by the assets of the International Development and Investment Bank itself. Only a relatively small part, say 20 or 25 per cent, of the capital of the Bank would be paid in, the rest subject to call when needed. The large unpaid capital of the Bank would constitute an asset amply sufficient to insure the value of bonds issued by the Bank. This, at any rate, would be true for many years to come, and eventually, as more and more of the capital has been paid in and invested abroad, new issues would be secured by the ever growing assets of the Bank and possibly by some accumulated surpluses. Eventually it might be necessary to increase the capital of the Bank leaving again a considerable unpaid portion which could be drawn on in the event of default.

International Currency Stabilization

It needs to be emphasized that mechanisms designed to facilitate stability in exchange rates must definitely be regarded as of secondary importance. Indeed such mechanisms will inevitably fail, just as the restoration of the International Gold Standard following the last war failed, unless it proves possible to maintain continuing prosperity on a fairly high plane throughout the world. If, however, substantially full employment can be secured in the leading industrial countries, and if international machinery can be devised for long-term international development loans, then it should not prove too difficult to establish and to maintain a workable international monetary system with substantial stability of exchange rates.

The monetary lessons emerging from the experience of the last quarter-century point clearly to the conclusion that there can be no return to an automatic international gold standard designed to serve as a regulatory mechanism. The control of the international monetary system which will emerge from this war must be a conscious control carried out through international collaboration. The new international system following this war must be managed through the concerted action of competent authorities operating through international institutions. Within the framework of an expansionist and developmental program designed to promote full employment in the mature countries and to raise the productivity in backward areas a system of exchange rates with a substantial stability but with a desirable degree of flexibility can be realized.

The new international standard must not be a task-master forcing each national economy to follow its dictates as in the old rigid gold standard; nor can it be a system subjected to the erratic disturbances of separatist national policies, as evidenced in the chaotic conditions of the early and middle 'thirties; instead it must seek to secure that flexibility necessary to permit a degree of national freedom, yet a flexibility tempered and restrained by international sanction and collaboration.

If the basic underlying conditions for international economic equilibrium are present, it might be argued (in the absence of deliberate action by governments) that stability of exchange rates would automatically follow and that there would therefore be no need for any specially designed mechanism intended to regulate the system of exchange rates. But this would imply a degree of perfection in the fundamental adjustments leading to equilibrium which cannot be reasonably expected. The essential purpose and function of an international monetary mechanism is to provide ways and means to soften the impact of disturbing forces tending to overthrow the equilibrium and to provide time for making the adjustments necessary to restore equilibrium. The international monetary mechanism not only acts as a safety valve by relieving pressure while more fundamental programs are being devised, but also acts as a weather chart by showing the areas of disturbance in which action will be necessary.

The essentials of an international monetary system appropriate under current conditions are relatively simple. A central pool of liquid funds must be established which can equalize any gaps developing in the balance of payments of each of the various collaborating countries. In all the various schemes, however novel or ingenious, that have been proposed there is no escape from the simple fact that any gap in the balance of payments not filled by gold transfers involves in essence an accumulation of international indebtedness, whether short-term or funded into long-term loans.

While in the new international system gold cannot be allowed to act as the regulator of basic internal or international economic policies, it can continue to serve as an international store of value capable of filling for substantial periods temporary gaps in international accounts.

Current Distribution of Gold

In order to appraise the degree to which gold may serve as international monetary reserves following World War II, it is necessary to make a quantitative appraisal of the current world gold situation. Three revolutionary developments with respect to gold are particularly relevant to this appraisal. One relates to the fact that for many countries the monetary gold holdings are now, or could easily be made, available exclusively for the settlement of international accounts. In contrast, prior to World War I, most of the world's monetary gold was put to internal monetary uses, either in the form of a medium of exchange in actual hand-to-hand circulation, or in the form of a base for note issues or demand deposits. The second revolutionary change in the gold situation relates to the current quantity of gold. In 1913 the total world's monetary gold amounted to only $4 billion (Russia excluded). Today the world's monetary gold, Russia excluded, is eight times that amount, or $32 billion. It is true that $23 billion is held by the United States. But what is usually overlooked is the significant fact that the rest of the world (Russia excluded) currently holds about $9½ billion of gold--which is slightly more than the total monetary gold in the world in the year 1925, a year in which the price level, measured in terms of American dollars, was approximately the same as today. A third revolutionary change relates to the volume of gold production, which in 1941 amounted to $1.3 billion (Russia excluded). With this figure one may contrast the production of about $450 million per annum in the period 1911-1915. Because of these three revolutionary developments it is clear that a vastly larger volume of gold can be used now to meet deficits in international account than was available twenty-five years ago.

Yet while the world's (outside of the United States) current and prospective holdings of gold are enormous measured in terms of the standards of fifteen or twenty years ago, it would be dangerous to build an international monetary system with exclusive reliance on gold as the means of international settlement. This is true partly by reason of the unbalanced distribution of current gold holdings (outside the United States) and partly by reason of the still greater differences as between countries in the production of new gold.

The distribution of current gold holdings (outside the United States and Russia) is approximately as follows:

	(millions of dollars)
United Kingdom	750
British Dominions and India	1,070
Western Europe (Netherlands, Belgium, France, Spain, Portugal, Switzerland)	4,575
Scandinavia	435
Latin America	1,075
Asia (excluding Japan and India)	395
Africa (excluding British Africa)	75
Eastern Europe (Poland, Czechoslovakia, Austria, Rumania, Yugoslavia, Bulgaria, Greece, Hungary, Latvia, Estonia, Lithuania)	635

	(millions of dollars)
Germany	130
Italy	120
Japan	350

Gold production is highly concentrated in the British Empire. The gold production in 1941 in the leading production areas (exclusive of Russia) was as follows:

	(millions of dollars)
British Empire	805
United States	170
Latin America	105
Africa (excluding British Africa)	65
Asia (excluding Japan and India)	60
Japan	70

Partly by reason of the inequality in current gold holdings and in new gold production and partly by reason of the extraordinary foreign exchange resources which a large part of the world will need following the war, it will be necessary to form an international pool of foreign exchange funds to supplement the available monetary gold resources. Unless we provide resources which will ensure an adequate supply of foreign exchange, many countries may quickly be compelled to resort to severe restrictive policies, including quotas, exchange control, and bilateral clearing in order to protect their balance of payments position. These restrictive policies must inevitably curtail trade, employment, and production. The repercussions therefrom cannot fail to spread throughout the world.

While it will be necessary to provide foreign exchange resources other than gold, these resources should accomplish some other purpose than merely to add, so to speak, artificial gold to the current gold stock. Indeed, it is important that the international foreign exchange mechanisms serve the purpose of reducing the reliance upon gold and of facilitating adjustments leading to equilibrium. If indeed this is done (and particularly if gold ceases to flow continually one way to the United States) there will be greater reason for hope that at long last a vigorous attack will be made through international action to limit the new production of gold to a level more reasonably commensurate with needed monetary requirements. On the other hand, we can be sure that the problem of gold production will not be attacked by international collaboration until the one-way flow to the United States is stopped. In this connection, it should not be overlooked that a high degree of liquidity, particularly in the leading industrial nations, is essential if we are to continue to maintain, as we should, low rates of interest in the money and capital markets.

If the current monetary gold stock were more evenly distributed, it would probably be sufficient to insure adequate international monetary reserves. But it is just the unequal holdings which require the creation of supplementary international monetary resources. It must always be remembered that these international monetary resources must be regarded as an international pool which serves the purpose of forming a cushion or temporary stop-gap until more fundamental adjustments leading to international equilibrium can be brought about, and that they cannot perform this function if they are concentrated in a single country or even in a few countries.

From the stream of recent monetary thinking two major types emerge--each designed to provide foreign exchange resources other than gold. The first type can be described under the title, an International Stabilization Fund, along the lines suggested by the United States Treasury. The second can be described as an Overdraft Clearing Union, as proposed by the British Treasury. In essence the two proposals are not widely divergent and accomplish much the same results.

Fund and Overdraft Proposals

The International Stabilization Fund establishes a pool of exchange resources to which each of the collaborating countries contributes in accordance with some prearranged formula. The contribution made by each country to this central Fund should be made in its local currency, or in gold. Each country might be required to make as an initial payment only a part of its full contribution, say, 50 per cent. In the case of the United States and other countries with large gold holdings in relation to their contribution, the contribution might be required exclusively in the form of gold, though no country would be required to contribute more than a certain per cent of its total gold holdings. Countries having small gold resources might be permitted to make their contribution exclusively in the form of local currencies. Whether the local currency contributed by a country were supplied from central bank credit or from the budget would be a matter for internal domestic policy.

The contribution of each country of local currencies adds in effect exchange resources to the gold holdings and new gold production available for the settlement of international accounts. International reserves are increased in so far as member countries obtain the right to purchase foreign currencies through the Fund on the basis of contributions of local currencies rather than gold. The new international reserves, it may be noted, are less powerful than gold. The country's right to draw on the Fund is restricted, not only over-all, but also in terms of any particular foreign currency.

What magnitudes ought reasonably to be considered in fixing the global amount subscribed to the Fund? In the event that the major problem (possibly following a temporary redistribution of gold incident to repatriation of foreign balances and holdings of securities in this country) should turn out again to be a world shortage of dollars, the magnitude of the global contribution to the Fund can be posed in terms of the provision of a reasonable supply of dollars. Considering the fact that the outside world holds over $9 billion worth of gold, it would seem that an International Stabilization Fund of $12 billion, with the United States supplying 25 per cent of the global quota, should prove adequate and at the same time hold to reasonable dimensions the contribution of the United States.

The Plan for an Overdraft Clearing Union similarly provides additional international resources over and above the current gold holdings and the new gold production. It is proposed that these resources shall be created as called for by central bank credit. No funds are initially paid into the central pool. Instead, as gaps develop in the balance of payments, each of the countries with a credit balance (in other words, countries with an "export surplus" whose currencies are in great demand by other countries) are called upon to make available the requisite amount of their local currencies in exchange for a claim upon the currencies of all other countries. The claim of foreign currencies might conveniently be universalized in the form of an international monetary unit (bancor) which would serve as a standard of measurement for all currencies and which would be exchangeable at fixed exchange rates for the currencies of all collaborating countries.

The Overdraft Clearing Plan differs from the International Exchange Fund in the respect that under the latter the amount of local currency or gold which any country is required to contribute to the Fund is limited to a specified sum. Under the Overdraft Clearing Plan the amount of local currency which any one "export surplus" country might be called upon to supply could theoretically equal the global overdraft quota of all member countries minus its own overdraft claims. Therefore a limit should be imposed, in the case of the Overdraft Plan, upon the obligation of any one country. The difference between the two plans can readily be seen from the following: Under the Fund plan each country contributes to the Fund a definite supply of its own currency or gold, and it is given a right to draw by an equivalent amount on the Fund. Under the Overdraft Plan each country, instead of making a contribution, accepts the obligation to supply its currency against a claim on foreign currencies, and each country is assigned a contingent claim upon other currencies. Thus for any country (such as the United States) the amount of dollars which we might be required to supply (were no limitation imposed) might equal the sum of the overdraft quotas assigned to all other countries combined. Since there are grounds for fearing that the liability of the United States might under such a plan become grossly excessive, a limit should be assigned to the currency which any one country is required to supply. Thus a limit of, say, $3 billion might properly be assigned to the United States unless increased by the special consent of this country. In this manner the United States liability need be no greater under the Overdraft Plan than under the Fund plan.

The Overdraft Plan is similar to established practice in the United States in the respect that under our unilateral gold purchase program the Treasury stood ready to supply dollars in exchange for gold at a fixed price. The Overdraft Plan similarly proposed that the central bank (in our case the Federal Reserve System) should stand ready to exchange dollars for "bancor" at the prevailing agreed-upon rate. The volume of "bancor" which other countries would wish to exchange against dollars would of course depend upon the supply of dollars necessary to equate the supply and demand for dollar exchange. All of this is similar to the gold purchase.

In fact, the United States could implement its part of the Overdraft Plan without violent departure from established practice. The Treasury might buy "bancor" (which is by international agreement accepted as equivalent to gold for purposes of international clearing) in exchange for dollars just as it has purchased gold. Against such "bancor" balances the Treasury could similarly deposit "bancor" certificates with the Federal Reserve, thereby rebuilding its balance and thus causing no drain whatever upon the budget. This, to be sure, would require legislation. Could such legislation be obtained, and would there be general public consent if the action were undertaken? It is arguable that this should not be too difficult. The public might react more favorably to the Treasury accumulating a credit of "bancor" (which represents under the Overdraft Clearing Plan a symbol for international collaboration to promote trade, economic expansion, and employment) than to the policy of buying gold and burying it in a hole in the ground at Fort Knox.

The essential difference between the Fund plan and the Overdraft Plan is that under the Fund plan each country is required to make a prior contribution of its currency or of gold whether or not such currency will in fact be in demand in view of the international balance of payments. Thus, as and when a "credit balance" country accumulates claims on foreign currencies, these claims would apply to monetary assets that are actually available in the Fund. In the case of the Overdraft Plan the claims of the "credit balance" country on foreign exchange would be balanced in the International Clearing Union simply by debit accounts on the "debit balance" countries.

Both the Fund plan and the Overdraft Plan differ from our Gold Purchases plan of the 'thirties in that the latter was completely unilateral and provided no machinery for international collaboration by means of which an equilibrium might be reached. Both the Fund plan and the Overdraft Plan provide such machinery and at the same time afford sufficient flexibility so that one may hope that equilibrium might be reached on the basis of expanding multilateral trade and full employment and not through the application of restrictionist and bilateral arrangements.

Creditor Country Adjustment

A definitely new approach should be adopted with respect to a program of international adjustment when one-way debts or credits begin to build up. In the past, it has often been assumed that it was peculiarly the international "debit" country which needed to make the adjustment. The adjustment which it would be necessary for the "debit" country to undertake would naturally consist either of (a) deflation, involving wage reductions and in extreme cases the arbitrary reduction of contractual interest payments and rents, or (b) the depreciation of the "debit" country's currency. It may be suggested that in the future emphasis should be laid upon adjustment in the "credit balance" countries and that appropriate policy in these countries is one designed to bring about expansion. If the United States, for example, continues to have an active balance it would be appropriate to introduce internal measures of expansion in this country, bringing employment and production up to a full employment level. At the point when income has been raised sufficiently so that inflationary developments are impending, it would be appropriate to appreciate the dollar. Such action would tend to club down the inflationary development of raw material prices whether agricultural or industrial. Typically, it is agricultural and industrial raw material prices which first show inflationary tendencies. This was true, for example, in late 1936 and early 1937 (probably the only period in the 'thirties when appreciation of the dollar could reasonably have been considered as rational from the standpoint of the internal domestic economy). Once full employment were reached and inflationary tendencies were under way, the appreciation of the dollar would serve as a means not merely to stabilize the internal economy but also to facilitate international adjustment.

Internal expansion to the point of full employment would not only render the policy of appreciation of the dollar feasible and in line with a program of internal stability but would also (as already noted at an earlier point in this paper) powerfully contribute to international equilibrium. That this effect would follow may be stated in a formal and technical manner as follows: Let us assume that governmental loan expenditures are undertaken to raise the income in the United States. As the expansionary process develops, a new equilibrium position is approached at which current savings equals internal investment (including governmental loan expenditures) plus the net export balance. The expansion in the United States will promote expansion of income in the foreign countries which in turn will induce a certain volume of savings. While temporarily this net increment of savings in foreign countries may be balanced by an induced investment, such induced investment would quickly run out as soon as the capital stock has been built up to the new income level after which only replacement investment would be required. Thus the new savings in foreign countries would, at internal equilibrium in those countries, have to be balanced by a net improvement in their balance of payments position and this correspondingly would mean in the United States a net decline in its active balance. This analysis points to the conclusion that an expansion in the United States relative to the outside world would tend to correct the disequilibrium in international accounts. A part of the expansionist program in the United States (the United States is here used as the leading example of an international "credit balance" country) might well take the form of an increase of international loans for the development of backward countries. To the extent that such loans were used to increase exports from the heavy goods industries, it would promote internal expansion in the United States; to the extent that the loans provided exchange funds for backward countries to purchase in other countries, it would help to fill the gap in the United States international account.

Backward countries might in certain cases be permitted to make special arrangements to encourage the inflow of foreign capital and stabilize capital movements. The Governing Board of the International Stabilization Fund or Overdraft Clearing Union together with the Governing Board of the International Development Authority would both be concerned to study the impact of capital movements upon the structure of the country and the ensuing effects upon the international exchange position of the country in question.

Internal expansion in the United States would facilitate not merely a managed appreciation of the dollar but also a thorough going program of tariff reduction. This is true because internal expansion makes possible a shift of resources out of "protected" industries into others which are expanding without creating undue hardships or unemployment. Thus these equilibrating measures (dollar appreciation and tariff reduction) fundamentally rest upon internal expansion.

Currency Adjustments

Under each of the plans proposed it is suggested that the essential criterion which should determine changes in the structure of exchange rates should be the degree to which the overdraft quota in the Union or the exhaustion of the right to draw on the Fund has been utilized in any one year. The suggestions that follow are not strictly in line with published plans but they serve to illustrate the principle. Thus, for example, if, say, one-fourth of the "quota" of a country has been used up within one or two years, the currency of such "debit" country might be depreciated by unilateral action by, say, 5 or 10 per cent and following the exhaustion of one-half of its "quota," a further depreciation of, say, 5 or 10 per cent be permitted. A defect in this procedure is that insufficient attention would be paid to the position of a "credit balance" country. With respect to the "credit balance" country, as already indicated above, appreciation of its currency should come only after internal expansion had developed to the point of full employment or at the beginning of inflationary tendencies. It is true that certain "debit" countries may be so seriously out of balance that the above measures undertaken by the "credit balance" countries would be inadequate and that the currency of a particular "debit balance" country seriously out of line must be depreciated.

In general, currency depreciation ought not to be permitted for the purpose of artificially stimulating exports. Competitive cut-throat currency depreciation cannot be helpful to general world stability. Put in more general terms, currency should not be "undervalued" or "overvalued." Currency adjustment indeed ought rather to seek a true equilibrium point which equalizes "efficiency wages" and money costs broadly conceived between the different countries. This, of course, does not mean that the unit costs of every particular commodity can or should be equalized, but rather that the general level of efficiency wages and costs should be equalized through adjustment of exchange rates so as to prevent artificial undercutting by any one country in other countries.

In particular, the Governing Board of the International Stabilization Fund should not deem it part of its prerogative to control national policy with respect to wages. We cannot permit an international monetary agency to dictate wage policy in the separate countries or to compel deflation of wages or even to insist upon a prevention of wage increases. The Board may legitimately advise about too rapid expansion which is leading to inflationary developments and seek with such powers as it has at its command to promote policies leading to stability in the different countries. If, however, a country permits a wage inflation to occur, the Board must take cognizance of such an accomplished fact and permit adjustment of exchange rates in order to facilitate, on the basis of the new wage level, international equilibrium. The influence of the Governing Board could, however, be very important in promoting internal policies in the various countries leading to internal economic stability, and thereby making easier the larger task of international economic stability.

The Role of Gold

An important question which requires careful consideration is the role of gold in such an international monetary system as is here under consideration. Under the proposals it is clear that any one country would always have international monetary resources equal to (a) its claims on foreign exchange as provided by the Fund or the Union, plus (b) its own gold resources.

If, however, all international purchases had to pass through the Fund or the Union, it would be possible to limit the amount of gold that any one country would be required to accept in exchange for its local currency. This would correspond to the provision in the Overdraft Clearing Plan that there might be a limit set to the amount of local currency which any one country would be required to make available to foreign countries. Such a scheme would limit the possible monetary use of gold. It might be argued that such a provision is desirable in order, on the one side, to compel more serious consideration of equilibrating policies and, on the other side, to insure that serious international consideration be given to a rational solution of the problem of gold production. It may be urged in reply, however, that a prior limitation on the use of gold might limit the willingness of the Fund or the Union to purchase gold, resulting in an unofficial gold market and high uncertainty with respect to the probable future price of gold, and hence in chaotic conditions in the gold production countries. It is probable that a better solution may be found in reliance upon the machinery for collaboration implicit in the Fund or the Union. If adequate equilibrating policies are undertaken through the Governing Board, and thereby a one-way flow of gold to the United States is stopped, it follows that a specific and systematic attack on restriction of the world output of gold must sooner or later be undertaken. It is probably better to rely upon international collaboration through the Governing Board of the Fund or the Union than to set up arbitrary limits on the use of gold designed to force action. It may perhaps be said that in the final analysis the only merit in setting up a Fund or a Union is (a) that such a program would provide at the outset a somewhat more equitable distribution of international monetary resources, and (b) that the establishment of machinery per se gives ground for hope that international collaboration looking toward equilibrating policies will in fact be undertaken. There is indeed no assurance that the desired results will be reached, but it is perhaps even more to be questioned that rigorous limits on the use of gold would be any more likely to insure the achievement of adequate equilibrating policies.

The International Development and Investment Bank and the Stabilization Fund

Conceivably the functions of an International Stabilization Fund or an Overdraft Clearing Union (whichever were adopted) might be combined with the functions of the International Development and Investment Bank. It is believed, however, that it would not be good procedure to mix the two. The International Development and Investment Bank is designed to attack the more fundamental causes of unbalance in the world economy and to promote developmental projects, productivity, and full employment. The financial operations involved ought to be sharply differentiated from the financial operations of the Stabilization Fund.

Whether or not such differentiation were made in the form of two separate institutions, (1) Stabilization Fund or Clearing Union, and (2) the International Development and Investment Bank, it is at any rate true that a sharp differentiation must be made in our thinking and planning between two quite separate and distinct functions: (a) the creation of a supply of exchange, and (b) the provision of capital funds. The Fund or the Union provides a means to ensure that foreign exchange at established rates shall be available. They provide that exporters everywhere shall be able to receive payment in their own currencies whenever sales have been made across international boundaries. They ensure that whenever any person or corporation possessed of means of payment in terms of his own currency wishes to import from any place in the world, he shall be able to obtain the exchange. The function of providing exchange, however, does not involve the granting of purchasing power to the importer. The importer is presumed himself to be possessed of purchasing power in terms of his own currency, and the only question is that of ensuring that he shall be able to exchange his own currency for the foreign exchange needed. The problem therefore of ensuring an adequate supply of exchange is quite separate and distinct from the problem of providing funds for investment and development.

Nevertheless, the two functions--(a) of providing exchange, and (b) of providing funds for development in backward countries--are alike in that both involve a form of international lending and both may be financed either through the budget or through the creation of central bank credit (though in the case of the international development projects, funds might of course be raised through the flotation of bonds in the capital markets without drawing upon the budget or upon central bank credit). Both functions, to repeat, involve international lending. When foreign exchange is made available to other countries, the asset received in return for this form of international lending is a claim on foreign currencies. In the case of the supplying of funds for developmental projects, the asset obtained in return for this form of international lending is a claim on the new fixed capital which is constructed. One financial operation ensures an adequate supply of whatever foreign exchange is required, while the other merely provides funds in the local currency of the country in which the funds are raised. In the event, however, that it is desired to spend these funds in some other country, the problem of obtaining exchange still remains. The one financial operation involves the supplying of foreign exchange; the other involves the supplying of capital funds.

It is just such an issue as this that suggests the probable advantage of making sharp separation between the Stabilization Fund or the Overdraft Clearing Union (designed to provide foreign exchange) and an International Development and Investment Bank designed to finance international development projects. The two things ought not to be mixed, and accordingly there may be an advantage in separate institutions each with its own functions.

Financing Foreign Investments and Financing Commodity Stabilization

The question remains whether it might be appropriate for the International Development and Investment Bank to obtain a part of its funds by discounting at central banks. The funds for international development projects, as indicated in a section above, ought probably to be financed ultimately either from the capital funds of the International Bank (contributed by the collaborating governments by budgetary appropriations) or from flotations in the capital markets. Interim financing, however, might well be undertaken by the Bank through discounting of its own notes at central banks. In the case of the International Commodity Corporation, however, a good case might perhaps be made for long-term financing by recourse to central bank credit. Such a corporation is expected to buy and sell storable raw materials and to stabilize their prices. The utilization of central bank credit to provide funds for such a corporation might be defended on the ground that the corporation would be continuously buying and selling storable raw materials and would not ad finitum accumulate an ever-mounting volume of stocks. Thus in the process of its operation the volume of credits would automatically be limited to fairly moderate proportions. Also it could be argued that storable raw materials are peculiarly an asset upon which central bank credit might legitimately be granted, since the commodities are storable, used throughout the world, and readily saleable. The case is obviously quite different from that of an International Development and Investment Bank which as it expands its operations would invest in an ever-increasing volume of fixed capital.

Fund or Clearing Union

An International Stabilization Fund or an Overdraft Clearing Union would equally serve the purpose of supplying the necessary volume of foreign exchange and promoting the exchange and other adjustments necessary to secure international equilibrium. If the Overdraft Plan were adopted it would be necessary that the Governing Board should satisfy itself that monetary and banking legislation (including the charter of the central bank) are adequate to meet the overdraft obligations. If these conditions are not satisfactorily met, the country in question would be required to deposit with the Union local currency up to its maximum obligation.

In the case of the Stabilization Fund a "credit balance" country (the United States, for example) would accumulate a claim on assets already paid into the Fund, whether in the form of local currencies or of gold. In the case of the Overdraft Clearing Union, apart from gold holdings, the balance of the "credit" country is represented only by a claim on foreign currencies. It is difficult to see that this really constitutes a genuine advantage in favor of the Fund, unless one takes a position representing complete lack of confidence in international institutions. Such a position would logically lead to a demand for the physical possession of gold within one's own political borders. The mere fact that the International Stabilization Fund would be actually possessed of local currencies does not appear to offer in fact any real advantage over and against the claim of the Overdraft Clearing Union on the "debit balance" countries. In either case the value of the assets in question depends in fact upon the workability of the international collaboration under consideration and the good faith of international credit.

In conclusion, one might quote with approval the following words by Jacob Viner (Yale Review, Autumn 1943): "With respect particularly to the two draft plans, I have probably made it sufficiently apparent that my own preference is for a blend of the two, with only a few substantial deviations from both. Suggestions for important departures from either plan have come and will come from many quarters, and some of these will no doubt be of great value. I am convinced, nevertheless, that as compared to the pre-war situation adoption of either plan very much as it now stands would be a great step forward, in the mutual interest of all countries wishing an orderly and collaborative world."