MONETARY AND CREDIT AGREEMENTS

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BRETTON WOODS

by

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Last August while in London I had opportunity to study the plans for reconstruction and postwar economic stability of some of the governments in exile--particularly Belgium. The problem is immense, and its solution, or lack of solution, will affect us. It is an international problem.

The American people want to know, and rightly so, what our Government is planning for the postwar era.

As you know, plans are well advanced for the establishment of a food and agricultural organization of the United Nations. The meeting at Yalta has cleared the path between Dumbarton Oaks and San Francisco. And as the President told the country, on March first of this year after his return from Yalta, work is progressing on proposals to strengthen the Trade Agreements Act of 1934, to secure international agreement for the reduction of trade barriers, to control cartels and to provide for the orderly marketing of world surpluses of certain commodities. Within the past few weeks considerable progress has been made at the Mexico City Conference in dealing cooperatively with problems of this hemisphere.

During much of the period between the First and Second World Wars, one of the greatest obstacles to the orderly exchange of goods and services between countries was the uncertainty and difficulty which surrounded payment for these goods and services. The conference held at Bretton Woods last summer--which I had the privilege of attending--agreed on far-reaching proposals designed to remove this obstacle and enabling legislation is now before our Congress.

What were the conditions in the two decades between the wars? Peace after the First World War was precarious and chaotic. In the political field, many countries experienced revolutions and counter-revolutions, or at the least frequent changes of government. In the economic field, much industrial plant had to be rebuilt to serve the needs of peace instead of war, and overworked farm land had to be reconditioned. People who had gone without through the war years scrambled for the meager available supplies of consumer goods. Prices shot up and we experienced all over the world a postwar inflation. International exchange was out of joint. Commercial contacts, broken by the war, were difficult to restore. Exchange could not be found to buy the imports needed for reconstruction and to put national economies back into working order. Monetary disorders spread throughout the world. Those who could, shifted their funds about looking for a "sound" currency--one that had some stability.

It is generally known that before 1914 the value of most currencies had been expressed in terms of so many grains of gold. Since gold was a commodity accepted the world over, this was an easy means of comparing the relative values of different currencies. For example, the French franc was fixed by law at about one one-hundredth of an ounce of gold. The English pound sterling was fixed by law at about one-quarter of an ounce of gold. Therefore, by simple arithmetic, one pound sterling was the same as 25 francs or one franc was one twenty-fifth of a pound. Because of this fact, international trade could effect the exchange in goods based on a known relation between currencies of various countries.

With the outbreak of the First World War, most countries refused to permit the export of gold and their banks ceased to pay out gold to individuals. The gold standard was abandoned. After the war, however, every effort was bent to return to the gold standard. But it was not always possible and in some cases it was not desirable to return to the old values for the various monetary units. England, however, did; so strong was the desire to return to what was considered to be normal relations that, in 1925, a pound was declared to be worth as much in terms of gold as it had been before the war. But this was too high a value for the pound, and it proved a great strain to maintain that value. Unfortunately, there was no international machinery under the gold standard under which the rates could be altered. There was no flexibility. There was rigidity. A change in the par values of currencies was a major operation which had its repercussions on the economic nerve structure of world trade. On the other hand, France did not return to the old value for the franc. The impact of the war and reconstruction upon the French economy had lifted commodity prices and made goods much more expensive in France. That is, it took far more francs than before the war to buy the same quantity of goods. By the same token, it took more francs to buy a pound sterling; the exchange value of the franc fell. Then in 1926, the franc was stabilized at approximately 125 francs to the pound instead of 25, as before the war. There was no possibility of returning to the old parity, and France was realistic in not endeavoring to do so. But a flight of capital had preceded French stabilization and the return flow afterwards aggravated the difficulties of other countries, especially England.

You can imagine, if you do not recall, how difficult it was to carry on international commercial and financial business under these changing and uncertain conditions. There was basic uncertainty in values--in prices--in exchange. These conditions were needlessly protracted because each country operated on its own. There was no comprehensive plan for collaboration and cooperative action to restore a functioning international monetary system. Small loans were made to some countries to help them stabilize their currencies; but this assistance was sporadic and uncoordinated. Each case was treated separately. Toward the end of the 20's it was vainly imagined that normalcy had been restored. But the difficulties in the international field were even worse in the 30's than in the preceding decade.

As conditions in the 20's had settled down there had begun to be a considerable volume of international investment. Part of this was in long-term loans on which the interest and amortization charges made a heavy call upon the borrower's foreign exchange resources. Much of it represented short-term lending, partly in the form of deposits in foreign banks and the purchase of speculative securities, partly the financing of trade, Large quantities of goods were imported by the debtor countries on credit. In many cases, borrowing far exceeded the capacity of the country to repay, especially since the funds borrowed were not used to enlarge the productive resources of the country. In time some countries had to pay more for the goods and services they bought, plus net credit charges, than they received from their own goods and services abroad--that is, their balance of payments was said to be "unfavorable".

It appeared necessary to impose restrictions upon purchases and sales of foreign exchange and upon international trade because the ability of many countries to maintain their purchases abroad had come to depend on their ability to borrow abroad. Few were able to do so. At the end of 1935, virtually all intergovernmental debts--save that of Finland--and 38 per cent of private bond issues were in default. At the end of the 20's, the volume of funds available for foreign investment began to dwindle; and finally, as confidence weakened, short-term funds began to be withdrawn. Debtor countries could not meet these drains except by shipping gold or using available foreign exchange. Obviously, there is a limit to this process. There was no machinery for international cooperative action to deal with such a situation. Each country felt that it was "on its own" and hastened to clamp on exchange and trade restrictions. Some hoped to stimulate their exports by making it cheaper for other countries to buy their goods. They did this by reducing the price of their currency. They depreciated. At the same time they tried to reduce their imports. The result was a general falling off in world trade. Exporting countries began to suffer from declining production and increasing unemployment. Countries whose economies were geared to a high level of imports could not find the exchange to pay for their imports. As a result the value of international trade in 1934 was only about one-half as great as it had been in 1929.

All this added up to the world-wide depression of the 30's which is still fresh in our memories. At that time I was here in Chicago and well do I remember our situation, for I was then City Comptroller. The banks were closed. Tax collection was held up by a reappraisal of real estate. And when we began again to collect taxes the depression was upon us and property holders were unable to pay taxes. People were out of work. Each blamed the other for the difficulties. Back of the domestic depression was a world economic situation.

To keep things moving even on a low level, countries began to make agreements with others on the basis of "I'll buy more from you if you will buy more from me". Trade was forced into bilateral channels. Countries no longer bought in the most advantageous market. They bought wherever they could make a deal through the maze of regulations and restrictions which hampered international exchanges. There is no need to describe here the devices--some of them ingenious and all of them intricate--which were invented in this deadly game of economic war. We know now that it was almost as destructive to national and international well-being as had been the actual hostilities of the First World War. And it laid the basis for the Second World War.

I have taken this much time to recall to you the handicaps which confronted international trade after the last war because some people appear to have forgotten them, or at least their memory has dimmed. But those who were alert to the dangers of a repetition of these conditions after this war have devoted time and energy to seeking a way to avoid such a recurrence if possible. Interested individuals

began systematic study more than three years ago. After many conferences and discussions, preliminary, highly tentative proposals for an international monetary institution were presented to the public in April 1943. A draft for an International Stabilization Fund was published by the United States Treasury and a draft for an International Clearing Union was published by Great Britain. Both proposals were put forward to encourage all interested parties to contribute to the solution of the extremely complex problems involved. Both proposals were widely studied, compared, debated and discussed, orally and in writing, by individuals, and in small and large groups, here and abroad. As a result of the wide area of agreement that was found to exist, a Joint Statement of Experts was published in April 1944. Further discussion culminated first in a preliminary meeting of representatives of many nations in Atlantic City in June and finally in the July Conference at Bretton Woods. The Bretton Woods Agreements, especially the Fund proposal, are designed to aid in achieving reasonable stability in the international monetary sphere in order to make possible a revival and expansion of world trade on a multilateral basis. They are a step--and a long step--in the right direction.

Admittedly the Bretton Woods Agreements are not a panacea for all the ills of the world. Unless the major industrial countries, especially the United States, succeed in maintaining reasonable stability of employment at high levels there will be very little chance of avoiding the measures of economic warfare employed in the 30's. In effect, these were measures to "export unemployment". By importing as little as possible and exporting as much as possible, each country

hoped to keep its own people working. There is reason to believe that the major countries now are determined by domestic measures to prevent wide fluctuations in employment. Economic stability and full employment in the United States are certainly an accepted aim and purpose. But these should be reenforced by a healthy condition of international trade. The acceptance of the Bretton Woods Agreements will contribute in a substantial measure to the ability of countries to maintain employment at high levels without resorting to attempts to "export unemployment" to other countries.

If we are to have a healthy world trade, we need reasonable stability in foreign exchange rates, and adequate credit distributed where it will do the most good in rebuilding and developing national economies. The Bretton Woods Agreements are technical documents, the product of the experts of 44 nations, but they can be summed up simply. They spell out cooperation in the monetary and credit fields, and give detailed ways in which this cooperation can be achieved. The Agreements provide for the establishment of two international institutions; an International Monetary Fund, and an International Bank for Reconstruction and Development.

The Bank proposal is relatively simple. No serious differences of opinion arose in the negotiation of the Bank agreement, which has received widespread support and approval. The Bank follows a well-known pattern. Its job is to investigate projects for the reconstruction of war-torn areas, and for the development of backward lands for which long-term international loans are needed. When it is satisfied

that a project is productive and that the borrowing country has a reasonable prospect of repaying the loan, the Bank will see to it that the loan is forthcoming on reasonable terms. This does not imply the elimination of private investment but it is unlikely that enough private capital will be lent to countries in need of reconstruction or development without some encouragement, especially immediately after the war when conditions will be uncertain. The Bank will operate for the most part either by guaranteeing loans made by private investors or by making loans with funds borrowed from private investors.

The benefits of the International Bank will be many. It will help members to achieve stable economies. It will distribute the risks of international lending. Although we may furnish most of the loans which the Bank guarantees, this country's share in meeting the risks involved will be only $3 billion as a consequence of its subscription to the Bank. If international loans are made through the Bank, the dangers of imperialistic lending will be avoided. International supervision of foreign loans will make it difficult for foreign loans to be used as an instrument of political policy. The conditions which surround the issues of debentures by the Bank insure that they will be a prime investment security since the total of the Bank's loans and guarantees may not exceed the amount of its capital, surplus, and reserves. Only one-fifth of the $9.1 billion subscribed by member governments can be used directly for making loans. The rest will remain in the form of unpaid subscriptions as a guarantee fund to meet any losses that the Bank may incur.

The International Monetary Fund Agreement deals with a more difficult problem than does the Bank. Wider differences of opinion had to be reconciled before the negotiations were concluded. Changes will have to be made in it from experience. There is provision for amendment and there is room through interpretation for adjustment to conditions as they arise. It aims to prevent a repetition of the chaos which followed the last war and of the destructive monetary practices of the 30's, both of which I have reviewed. It substitutes cooperative international decisions and international action for the state of affairs we had in the past when each country made its own decisions and acted alone in what it thought were its own interests.

Under the Fund Agreement each member establishes the gold value of its currency by agreement with the Fund. Gold is still the most widely acceptable means of international payment. But this is not a return to the old gold standard. Although each country undertakes to maintain the established value of its currency at par, there is necessarily provision for altering the parity if it becomes evident that this value is too high or too low (because of changed conditions in the country's international position). The Fund will approve only changes that are really necessary, and object to those which are not. This means that no country will be able to sell its currency cheaply--that is, to depreciate its money in order to secure a competitive advantage for its exports. We have learned that if this is done, other countries are not likely to stand by idly but will join in the scramble with disastrous consequences for all.

The Agreement also eliminates special exchange rates for particular types of transactions. Germany was the country which developed this device most fully. In the years before the war there were all sorts of reichmarks, representing the receipts from different kinds of business with Germany. The non-German owner could not dispose of these freely since the use of each type was limited to a particular purpose such as to pay tourist expenses in Germany, to buy certain types of goods, and so on, and the value of each kind in terms of other currencies varied greatly. In this way Germany arbitrarily made it cheaper or more expensive to buy particular German goods or to sell particular commodities to Germany, and manipulated this device to obtain a competitive advantage in international trade.

The requirement that the Fund approve necessary changes (after the first 10%) will also mean greater stability of exchange rates in the long run. Not only will unnecessary changes be eliminated, but necessary changes can be made in an orderly way before the situation is completely out of hand.

If French production costs (wages and other items) for instance, happen to rise much above production costs in England, French producers will gradually lose their foreign markets--both in England and in other countries--to British producers. French producers will lose even in their domestic market, as their high cost goods are being increasingly displaced by lower cost goods imported from Britain. If the basic maladjustment in the cost structure is not the result of a temporary condition, but reflects a fundamental and lasting change, French production will eventually decrease, unemployment will rise and monetary reserves will

be drained by the deficit in the balance of payments. The French currency will tend to fall in value, speculators will rush to buy foreign exchange and, in many cases, the resulting monetary depreciation of the French franc will be greater than what was really called for to correct the initial cost maladjustments. If an appropriate change is made in the value of the currency relative to the currencies of other countries before this train of circumstances is set in motion, much confusion and distress will be avoided and the necessary adjustment can be an orderly one.

European currency history between the two wars illustrates this problem in the clearest possible way. As I said before, in 1925, England went back on the gold standard at the prewar gold parity, while continental countries depreciated their currency to a considerable extent. The resulting cost disparities between England and other countries resulted in a severe and protracted economic depression in Great Britain until the devaluation of the pound in 1931. As the pound declined further and further in the following years, production costs in Europe increased in terms of sterling and, in turn, became completely out of line with British costs. The attempts of the gold block countries to maintain the parity of their currencies in the face of such heavy international cost disparities led to intense depression and unemployment and proved futile in the end. Belgium was the first country to bow to the inevitable. Her relatively prompt decision permitted her to limit the devaluation of the Belgian franc to only 28 per cent. France meanwhile resisted to the last, with the result that the devaluation, when it came, depreciated the French franc by about 60 per cent as compared with the Belgian 28 per cent.

Under the Agreement also, all members promise to eliminate restrictions on foreign exchange transactions as soon as possible. Of course, during the war, each country must keep strict supervision over its international transactions. I am not speaking of war-time controls but of the sort of regulations in effect before the war. Many countries at that time had less foreign exchange than they needed. That meant that importers in those countries were rationed as to the amount of foreign exchange they could use, and exporters were required to turn over their receipts to some governmental agency which parcelled them out. This arrangement, as we have seen, interfered with normal trade, which was shifted into particular channels, and often led to the domination of the economy of one country by another for political ends.

The case of Germany and Hungary illustrates what happened. In preparation for war, Germany was anxious to acquire large stocks of goods, and was willing to pay well for them in German marks. The Hungarian Government had subsidized farm output in order to avoid the bankruptcy of its farmers when agricultural prices in world markets dropped, and the prices of Hungarian wheat and meat were much higher than Germany would have had to pay elsewhere. But Germany could not buy elsewhere because it did not have the dollars or the pounds or the pesos to do so. An agreement was signed between Hungary and Germany whereby Germany agreed to take Hungarian goods at the high Hungarian prices, and sell to Hungary German goods--also at high prices. The transactions were balanced against one another in a "clearing account".

Each country tried to prevent an unsatisfied debt from piling up in the clearing account. Under this arrangement both Hungary and Germany were paying more than they should have for the goods which each imported from the other. Hungary lost its other markets because of its high prices and had to concentrate on the German market.

Germany began to dictate trade terms to Hungary, to tell it what sort of goods it must produce if Germany were to take them. When Germany went to war, the Hungarian economy was firmly tied to that of Germany and thus Hungary inevitably became a partner of the Axis.

This is the sort of thing we do not want to have happen again. Under the Fund Agreement, members undertake to abandon such bilateral clearing arrangements and discriminatory currency practices as give exporters special premiums if they ship goods to countries the currencies of which are particularly desired. This commitment applies to the abandonment of restrictions on foreign exchange transactions on current account, that is, those arising out of shipments of goods, tourists' expenditures, immigrant remittances, and the rendering of services. Members are permitted to control capital transactions such as money sent for deposit in foreign banks or for use in stock market operations. Real investment can be encouraged and the speculative movement of funds limited; this will contribute substantially to international monetary stability.

It is not expected, of course, that the whole body of regulations over foreign exchange transactions shall be done away with at once. Only confusion would result. The patient is very sick, and

Another automatic control is the obligation of all member countries to repurchase their own currencies from the Fund with gold or foreign exchange. This obligation is so framed as to require countries adequately supplied with gold and foreign exchange reserves to draw on them at the same rate that they draw on the Fund. And it also requires (with qualifications) countries which are gaining gold and foreign exchange to use half of the amounts gained to reduce their drafts on the Fund.

The discretionary controls are even more important than the automatic controls. The Fund can postpone the beginning of its exchange operations until it is satisfied that most members are in sufficiently stable condition to warrant use of the Fund's resources. Furthermore, once it has commenced general exchange operations it can postpone transactions with any individual country which is not in a position to make appropriate use of the Fund's assistance.

Once the Fund has begun operations with any member, however, that member can proceed with the assurance that it can come to the Fund and receive help in meeting payments due for foreign goods and services without delay. This feature of the Fund proposal lies at the very core of the whole agreement. It assures the availability of exchange. Since members can confidently expect assistance from the Fund, they will be able to undertake to maintain stable exchange rates and to eliminate restrictions on foreign exchange transactions. In many cases the fact that assistance is forthcoming without delay will prevent temporary disturbances from having serious repercussions on the international position of other countries. If a drop in any single country's

It has been argued in some quarters that foreign countries will abuse their privilege of drawing on the Fund and that the Fund's resources will be wasted. The position taken by the critics is that in order to insure that members take advantage of the time during which they are drawing on the Fund to correct the unbalance in their international position, aid should be given only after special investigation and agreement as to the conditions under which the funds are to be used. This view misinterprets the very essence and purpose of the Fund.

A whole series of automatic and discretionary controls is specifically designed to prevent undue use of the Fund by any member country and to ensure wise use of the Fund's resources.

Take, for example, the important automatic controls. Definite limits are established on the amount of foreign exchange a member may obtain from the Fund in any single year or as a maximum over a period of years unless special permission is given to exceed these limits. Secondly, member countries must pay a small service charge on all foreign exchange purchased from the Fund. In addition, an annual charge is levied on a member country using the Fund. This charge increases, the larger the use of the Fund's resources, and the longer the period over which the resources are used by a member country. Thus, constant pressure is put on a member country to reduce its drawing on the Fund.

recovery, at best, can be only gradual. On the other hand, unless a concerted effort is made as soon as possible to eliminate such practices, there is grave danger that many countries will fall back on them to balance their international transactions after this war. They must have an alternative which will make such action unnecessary.

However earnestly the member countries may desire to live up to their agreements as far as exchange rates and exchange restrictions are concerned, it will not be easy for them to do so. To help them, a Fund of almost $9 billion is to be established, made up of gold and the currencies of all the countries which are members. This Fund will be used to assist member countries faced with temporary balance of payment difficulties such as might follow a bad crop or a loss of a market for a short period. Should the deficit prove to be more than temporary, the Fund will continue to give the member assistance only if it takes adequate steps to correct the situation.

I have sketched briefly the mechanism of the Fund, and indicated the aims which it is hoped it will achieve. Doubtless, you have all heard and read some criticism of this plan, and I should like to mention the main point around which this criticism centers. During the last twelve or thirteen days I have been attending and closely following the hearings on the Bretton Woods proposals in the Banking and Currency Committee of our House of Representatives and feel that the quest for information concentrates mainly on this point.

exports leads to defensive deflationary measures and restrictions on imports, that country's exchange difficulties will spread to other countries and a vicious circle of restrictions on trade and deflation will ensue.

Should the difficulties of a member country prove to be more than temporary, the Fund has a very important discretionary power to ensure that the country does take advantage of the time during which it is drawing on the Fund to put its house in order and correct its position. The Fund can stop a member from drawing on the Fund if it is not using its resources in accordance with the purposes of the Fund. The purposes as stated in the Agreement make it quite clear that the Fund is to be used to help countries meet temporary deficits and to give them time to correct more deep-seated maladjustments.

It is evident to me that the period during which the Fund and the Bank are needed most is the immediate postwar period before individual countries begin to impose new and additional restrictions on foreign exchange and foreign trade. Prompt establishment of the Fund and the Bank would also give member countries confidence which they must have to place their economic houses in order with the least possible delay.

It therefore seems to me that with the knowledge we have of the problems of the 1920's and the 1930's we have agreed at Bretton Woods with competent representatives of other countries on sound economic principles to help solve these problems and the solution of these problems is in our interest. Therefore the International Monetary Fund and the International Bank for Reconstruction and Development should, after due and proper consideration, be approved by our Congress.