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Fund and Bank: The Basic Facts About Bretton Woods

Major Elements of Strength and Logic in the Plan

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EVEN A CASUAL inspection of foreign-trade and investment developments from the end of the last war to the beginning of the present war shows that our past experience has been far from satisfactory. It may be characterized briefly as erratic and unstable. Our foreign trade fluctuated violently during the interwar period. One of the most drastic changes was from 1929 to 1932, when our exports and imports alike declined by some 70 percent. Thereafter we experienced only a partial recovery in foreign trade, which operated as both cause and effect in our incomplete domestic recovery. No established foreign trader needs to be reminded of the foreign-exchange problems which he faced during that time—the risks and uncertainties in buying and selling goods in times of exchange fluctuations—the difficulty in penetrating exchange barriers abroad and in collecting payment for exports when other countries were short of dollars with which to make payment.

With regard to foreign investments, I scarcely need recall our uncoordinated lending activities in the twenties and the abrupt cessation of these activities in the thirties. Our returns on foreign investments have not been as bad as many critics maintain, but the record does clearly show the effects of our hit-or-miss policies as an investor and of our instability as a creditor.

The only reason I direct attention even briefly to the past record is that many of the critics of the Bretton Woods proposals seem to have, on occasion, very short memories. I often see references to the "tried and proven" methods of the past. The record does not indicate much worthy of emulation.

The Fund's Prime Purpose

In the view of the Department of Commerce, the proposed Fund should be regarded as an endeavor to establish the international monetary relationships essential to the successful conduct of foreign trade and investment. It is an attempt to create an international monetary system. Let me emphasize—an *international monetary system*. Those words go to the heart of the question so far as the Fund is concerned. And it is here, in my judgment, that the critics of the Fund have seriously erred in failing to consider realistically the alternatives to the system agreed upon at Bretton Woods.

Let us approach the question from the standpoint of the foreign trader, whose activities are of such great importance to the prosperity of the Nation.

In addition to all of the other risks which any businessman must face, the exporter has to consider whether he will be able to get his money out of the country to which he sells. Will the proceeds of his sale be convertible back into dollars? In other words, can the foreign importer take his own currency to his bank and buy a dollar draft payable to the American exporter? Or will the proceeds be blocked and held idle abroad? Or will the use of the money be restricted, for instance, to expenditure on tourist travel, in which the exporter may have no immediate interest?

And if the exporter is able to get his money out, at what rate of exchange can he do so? Will it be the rate on, say, the franc or the pound prevailing at the time the sale contract is made? Or will it be some lower rate? If the rate between the dollar and the foreign currency fluctuates, who is to bear the exchange risk? Somebody has to do so, if business is to go on.

The exporter must consider not only the rate between the dollar and foreign currencies but also the rates between different pairs of foreign currencies. What about the position of competing exporters in other countries? Will the American exporter suddenly be driven out of foreign markets because foreign currencies are arbitrarily cheapened and his competitors are thereby given an unfair advantage? What, if anything, can the individual exporter, or his banker, do to protect himself against such competitive currency depreciation?

Importers and Investors

Nor should we neglect that very important individual, the American importer, who pays out the dollars that foreign countries must acquire if they are to buy goods. The importer faces most of these problems in reverse. Can he place his orders abroad in full confidence? Or must he hesitate and delay lest foreign-exchange rates fall and his competitors succeed in getting the same goods at lower prices?

We might also consider these questions for a moment from the standpoint of the investor. Here the currency and exchange relationships are even more critical because the obligations may extend over a long period of years.

These problems and many others of like nature do not arise in domestic business transactions because we have a unified currency and banking system. We still face many important domestic monetary problems. But the businessman and trader is at least free from worry that his funds will be blocked or that his dollar assets in Los Angeles, for instance, will depreciate as compared with his dollar obligations in Chicago. His funds can be freely shifted about within the country, and there is no uncertainty, beyond the usual credit risks, as to the ability of his customers to make payment and no concern as to the value of the currency in which he receives payment.

Past Inadequacies

We have no such unified and smoothly working monetary arrangements in the international sphere. And, except for a very short time during the latter part of the nineteen-twenties, we have not had anything approaching an international monetary system for 30 years—not since the gold standard broke down under the stress and strain of the First World War. To be sure, we have had monetary *relationships* with other countries. But they have been chaotic rather than orderly. The entire interwar period was characterized by exchange instability, on the one hand, and by improvised, unrelated attempts to rectify the situation, on the other hand. These attempts have been made chiefly along national and uncoordinated lines. The history of exchange fluctuations and exchange control bears sufficient testimony to the inadequacies of these efforts.

I do not mean to suggest that we should attempt to construct an internationally unified currency and banking structure comparable to that which the various countries have at home. No one is seriously proposing such a thing now. We must, however, move rapidly in the direction of a more orderly set of international monetary arrangements unless

we are to abandon hope of an expanding **world economy** and fall back everywhere on narrow economic nationalism.

Essential Features of System

What, then, are the essential features of an international monetary system and how are they provided for in Bretton Woods and other plans or counterproposals? We suggest that an international monetary system must provide the following:

(1) A high degree of exchange stability among the various national currencies.

(2) Freedom to transfer the proceeds of legitimate trade and investment transactions from one country to another.

(3) Adequate liquid resources to tide over temporary exchange difficulties or to permit time for more basic readjustments.

(4) International cooperation to integrate and conciliate national monetary policies in dealing with common economic problems.

Stability and Convertibility

As to the first of these key points, we know that we can never attain complete international exchange stability this side of a monetary Utopia with a universal currency and banking system. But we must aim toward the maximum possible stability of exchanges so that foreign traders and investors may be reasonably assured against arbitrary, capricious, or competitive reductions in the values of foreign currencies.

But stability of currency relationships is of little avail if it is achieved by rigorous exchange controls restricting normal business operations. An international monetary system must therefore provide, or aim toward, multilateral convertibility. It should be possible for the owner to recover the proceeds of sales of goods and services and of ordinary investment transactions without restriction or discrimination.

Exchange stability and convertibility cannot be maintained, however, unless the members of the international system have at their disposal adequate gold and exchange resources to settle temporary discrepancies in their accounts with each other. They must either own such resources or have access to a common fund. This means, in the international sphere, something closely analogous to the rediscount privileges of member banks of the Federal Reserve System in this country. Such arrangements are an established principle of central banking wherever it is practiced. If the members of the system, whether national or international, do not have such drawing privileges, they cannot proceed with confidence in the ordinary course of trade financing. And in time of stress they may be compelled to block claims accruing against them. International liquidity is the only satisfactory means of tiding over temporary exchange needs or of permitting gradual adjustments to more basic disturbances.

Monetary Cooperation

Decisions on these questions are of more than national concern. The determination as to whether exchange needs are only temporary or reflect a fundamental disturbance is of interest to all the trading partners involved. Under the Bretton Woods proposals, the right to draw upon the liquid reserves of the international system cannot exceed definite limits without the consent of other interested parties. It may be necessary to question and investigate whether the member drawing on these reserves is using them in a legitimate manner. It may also be necessary to insist upon repayment of the reserves drawn upon and to provide definite procedures governing return of the funds. All of these questions entail international discussion and collaboration. This cooperation between the various national monetary authorities is the last of the four principal features I have mentioned as essential to an international monetary system. May I summarize these key points in a few words each as follows:

(1) Maximum stability of exchange rates.

(2) A multilateral payments system.

(3) International liquidity.

(4) International monetary cooperation.

Agreement Is Explicit

These essential features are well provided for in the International Monetary Fund drawn up at Bretton Woods. What impresses us about the document is precisely the fact that these features have been *written out in detail* and *agreed to* by the representatives of 44 nations as a set of working principles which can be known and understood in advance.

The agreement states, as clearly as anyone could hope for at this time, how the exchange rates between the various currencies are to be determined initially. It prescribes how, and under what circumstances, and within what limits these rates may be altered. Clear prohibitions are imposed against exchange controls, discriminatory currency arrangements, and multiple currency practices; any exceptions are explicitly limited to temporary situations. The plan provides for the contribution, through quota arrangements, of resources necessary to provide international liquidity for oiling the wheels of commerce and for meeting temporary exchange shortages arising from fluctuations in international trade. The right to draw on the exchange resources of the Fund is clearly set forth to promote that feeling of confidence necessary to the revival and growth of trade. But access to these resources is circumscribed to prevent their depletion or their use contrary to the legitimate objectives of the Fund. International monetary cooperation is, of course, an organic part of the whole plan.

I shall not attempt to expound the detailed mechanics of the proposed Fund. But I want to emphasize strongly our belief in the necessity of these detailed provisions. If they are complex, it is because international trade and finance are complex. The Bretton Woods agreement is a sincere attempt to lay down in advance the essential "rules of the game." They are open for all to study. They are an attempt to go as far as possible in the direction of developing a rule of law instead of a rule of men.

In brief, we believe that the very detailed provisions of the Fund are probably not a disadvantage but are actually an element of strength. The weakness in most of the criticisms of the proposal lies precisely in their failure to face realistically the task of prescribing in adequate detail the policies and procedures that must be developed in this sphere.

Are Alternatives Feasible?

Let us now glance briefly at some of the possible alternatives to the Fund and see how far they go in providing the essentials of a workable international monetary system.

The first possibility is, of course, to go back to the situation which prevailed after 1929. This would mean abandoning the effort to construct an orderly set of international monetary relationships. If the possibilities of altering par values under the provisions of the Fund Agreement should appear liberal, consider the pre-war situation. There was no limit whatsoever on the right of any country to manipulate its currency at will, regardless of its neighbors' rights or interests.

On this score, Bretton Woods is a tremendous step forward. It is pointless to say that the Fund goes beyond the principles heretofore accepted by the United States in recognizing and approving changes in currency values. We have never had any choice in the matter in the past. Nor will we have in the future if Bretton Woods should fail of adoption, except as we may sporadically, here or there, attempt to bring our financial power into play. Likewise, the general obligations set forth in the Fund Agreement with respect to avoidance of exchange control should be contrasted with the epidemic of exchange restrictions that grew up before the war.

A second possibility is to follow a wait-and-see policy. I recognize that a number of persons sincerely believe that we should proceed slowly in this matter of international monetary cooperation. But I fail completely to see what they expect to gain thereby. As compared with the specific advantages which we have achieved in the Bretton Woods agreement, what are the prospects for a policy of delay? Could we hope to obtain agreement later on some perhaps superior plan for an international monetary system? At Bretton Woods many foreign countries made what they considered to be very important concessions to our insistence on the greatest possible measure of exchange stability and convertibility. These concessions have been under sharp attack abroad by interests anxious to retain greater freedom of action to vary exchange rates and to exercise restrictive controls. If we now fail to establish the basis for an international monetary system, the forces of economic nationalism will be offered every encouragement to entrench themselves permanently. Our chances of establishing an orderly, liberal set of international currency relationships would be immeasurably impaired by a policy of postponement.

Dangerous Suggestion

A third possibility is to scrap the Fund and to assign its general field of activity to the proposed Bank. In view of the time that would be required to give international consideration to this proposal, and also to the counterproposals that would inevitably come from other countries, this suggestion runs the same dangers as a wait-and-see policy.

The proposal has the apparent virtue of simplicity. But in reality it only postpones consideration of the whole range of international currency problems and makes them subject to later negotiation. What assurance have we that agreements ultimately worked out would be simpler than those achieved at Bretton Woods? And why should we throw away the commitments already obtained in the Bretton Woods Agreements against resort to arbitrary unilateral currency depreciation and exchange restrictions? Is it likely that a new set of negotiators could get more unequivocal and universal pledges along these lines?

To assign such general and ill-defined responsibilities to the Bank would set aside the carefully formulated and well-balanced set of international monetary principles agreed upon by all the nations represented at Bretton Woods after several years of careful study and preliminary negotiation. In place thereof, we would obtain nothing but the *unsecured promise* of further discussions, which could at best yield only a series of separately negotiated improvisations such as we have known in the past. If Bretton Woods is not adopted, each country will retain freedom of action. Instead of moving toward greater exchange stability and a more liberal multilateral system, we should probably be traveling in the opposite direction.

Essentially Negative

The various possible alternatives to Bretton Woods which I have mentioned are all essentially negative rather than positive in character. They aim at rejection of the proposed Fund but do not offer anything tangible in its place. However favorably disposed the critics of Bretton Woods may be toward the general idea of international monetary cooperation, they have failed to cope in a constructive manner with the down-to-earth problem of working out an alternative set of principles and procedures.

Another suggestion that has been made is that we revive the international gold standard. This has the virtue of being a more positive proposal than any of the other alternatives. But we all know that, in fact, it would be utterly impossible to obtain anything approaching general acceptance of a rigid gold standard. However, the Bretton Woods plan contains the best and most practical features of the international gold standard.

Position of Gold

As you are aware, the position of gold is fully safeguarded in the proposed Fund. The currencies of all members must be defined in terms of gold or of the present gold dollar. Each member is required to accept gold in exchange for its own currency. Members are required to maintain intact the gold value of their curriencies held by the Fund.

The chief apparent departure from the old gold standard is in the provisions for altering par values of currencies. This change is, however, more apparent than real. Under the old gold standard, countries were in fact free to alter the gold content of their currencies and to do so by unilateral action. The Fund regularizes and limits such changes in currency relationships. It rules out competitive currency depreciation and permits changes in par values only when necessary to correct a fundamental disequilibrium. In all cases other members of the Fund must be consulted before action is taken.

This is an important step forward. Moreover, it would be impossible to obtain the pledge to promote exchange stability if the Fund did not permit some flexibility when required to correct basic disturbances.

Domestic Soundness Vital

The Department of Commerce has repeatedly pointed out in recent years the repercussions on our foreign trade, and on the world economy generally, of wide cyclical fluctuations and unemployment in our own economic life. It would be foolish to suppose that international monetary and investment arrangements, however contrived, could be fully satisfactory unless we are reasonably successful in overcoming these twin evils at home.

If we wish to assure the fullest possible measure of exchange stability under the Fund, our best contribution will be to develop our own foreign trade on a sound, expanding basis. This means above all that we must endeavor to maintain our purchases from other countries at high and reasonably stable levels. Under these conditions we should find it possible to achieve the exchange stability and freedom of convertibility which characterized the old gold standard at its best. But without the foundation offered by Bretton Woods, we stand very little chance indeed of developing quickly the type and volume of trade which are necessary to this end.

Long-Term Investments

I think it is unnecessary to dwell on the desirability of international long-term investments. As long as capital remains relatively scarce in some countries, particularly in countries with rich but undeveloped natural resources, international investment should be a mutually profitable enterprise. The investors in the capital-exporting country may receive a higher rate of return on their capital than they could receive at home. The foreign country will be enabled to develop its economy at a faster rate than would otherwise be possible, thus improving the economic well-being of its citizens. The history of our own country and that of Canada furnish two outstanding examples of nations which have benefited greatly from the investment of foreign capital within their borders. The United Kingdom, the Netherlands, Belgium, and Switzerland may be cited as countries whose foreign investments have contributed substantially to the standard of living of their populations.

There can be no question that the United States will be in an unusually favorable position to make foreign investments in the post-war period. If a high level of economic activity is maintained—and we have every confidence in the ability of this Nation to maintain such a high level—the annual volume of savings available for domestic and foreign investment might amount to $25,000,000,000 or $30,000,000,000 a year. It is by no means certain that such a volume of savings can be invested at home unless much of it is done by the Government itself. Since returns on long-term capital are higher in many countries than in the United States, foreign investment would be a natural and profitable outlet for American capital. Moreover, the stimulus to our export trade provided by foreign investments would be a direct aid in maintaining the level of production and income desired for this country.

Past Experience

Unfortunately our past experience with foreign bonds has not been such as to inspire confidence on the part of individual United States investors. As every one knows, substantial amounts of our holdings of foreign dollar bonds have gone into default with a resultant financial loss to the American owners. I should like to point out some of the factors involved which we believe the present proposals for an International Bank will go a long way toward correcting.

Consider first the unsoundness of many of our past loans. Under the unregulated and uncoordinated lending practices of the 1920's, many loans were made without proper consideration of the debtor's ability to repay and without satisfactory procedures for ensuring that the loan proceeds would be used for productive purposes. Because of the very substantial commissions involved in underwriting foreign issues, there was an unhealthy competition among investment bankers, including many inexperienced and unscrupulous houses, which resulted in loans being placed without adequate consideration of their soundness. Financing was largely based on what the market would take rather than on what was good for either the borrower or the investor.

The proposal for the Bank provides well-conceived safeguards against unwise lending. Not only is each loan application to be carefully investigated by a technical committee, but the Bank is required to make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted.

Avert Excessive Borrowing

Secondly, the past has been marked by overborrowing by individual countries. Regardless of the ability of individual debtors—national governments, provinces, municipalities, or private corporations—to meet obligations from their own revenues and *in their own currencies*, it is clear that the total amount of *external* debt which a given country can service is limited by its ability to obtain the necessary foreign exchange, either through exports or by other means. The bank, in cooperation with the Fund, will be able to make exhaustive analyses of the current and prospective balance-of-payments position of a borrower, which should serve to prevent excessive total borrowing on the part of any individual country.

Terms To Be Reasonable

Next, we all know that past lending in the international sphere has frequently involved onerous terms. During the 1930's there was general feeling in many debtor countries that the loans floated by their governments in the United States had been incurred at too great a cost. The yield to the public on Latin American bonds offered in this market in the 1920's, for instance, averaged well over 6½ percent. In view of the large commissions paid to underwriters, the cost to the borrowers was much higher. If international loans are to be mutually advantageous, the cost to the foreign borrower must not be exorbitant. Since the avowed purpose of the Bank is to enter into a situation only when a prospective borrower cannot otherwise get a loan at reasonable rates, its influence will tend to keep the cost of external borrowing at reasonable levels.

Sporadic Lending Harmful

Perhaps even more serious than all other mistakes was the sporadic nature of our past lending. It is generally agreed that we not only lent unwisely and too much in the 1920's but that we stopped too suddenly. A world economy adjusted to large capital outlays by the United States was unable to withstand the shock of this cessation. The strain was particularly severe since it was superimposed upon a 70-percent decline in the value of our imports from 1929 to 1932. The decline in dollars supplied by way of long-term capital investment was over 90 percent—from $1,037,000,000 in 1929 to only $87,000,000 in 1932. This was a terrific shock in view of the dominant importance of the United States in world trade and the world economy generally.

The Bank cannot, of course, guarantee to prevent depressions. However, in addition to helping to maintain healthy conditions in the international capital markets, the Bank can serve to even out the rate of lending.

Another weakness in our past investment experience has been the unequal assumption of risk. There can be no question, I believe, that American loans to foreigners in the 1920's provided an initial stimulus to business throughout the world. The funds provided were spent, in the first instance, in many countries and stimulated world trade in general. When losses developed, however, the United States had to bear the burden alone. Under the proposed Bank all members share in whatever losses there may be from bad loans. Thus all the world will help to carry the risks of a program from which all the world will benefit.

Toward Cooperative Action

I have just returned from the Inter-American Conference on Problems of War and Peace at Mexico City. Important steps were taken there, with the invaluable assistance of members of Congress, to extend and strengthen cooperation among American countries in political and economic matters of mutual concern. All of us who attended the conferences were impressed, I think, by two things. One was the strong will on the part of all the nations represented to meet and solve international problems through international cooperative action. The other was the conviction manifest on every hand that political security and economic well-being are indispensable to each other. Thus the Dumbarton Oaks proposals, the Bretton Woods agreements, and the resolutions adopted at Mexico City together represent a progressive determination to build a lasting peace.

Philatelic Notes: Guatemala

A new issue of 3-cent postage stamps was placed in circulation in Guatemala on February 20, 1945, for a period of 6 months terminating August 16, 1945. The engraving is an allegory of the Revolution of October 20, 1944, the size 20 by 27 mm, the color bronze-blue, and the quantity printed 2,000,000.

Britain and U. S. Move to Unify Technical Drafting Practice

Production in the United States and Great Britain of aircraft engines and other equipment designed on either side of the Atlantic will be speeded up as the result of discussions now progressing in American factories and drafting rooms between a British mission of experts and American designers under the auspices of the Combined Production and Resources Board.

These experts are taking this action so that shop machinists in both countries will be able to understand each other's drawings and conventional designs. Although the common language of the engineer in all countries is the drawing, there are marked differences in design and drafting practice, CRPB says.

Such differences were among factors that caused a gap of 10 months between the arrival in the United States of technical drawings for the vital Rolls-Royce Merlin engine and the actual beginning of production.

At a recent meeting in Washington of engineers and officials of the two governments, William L. Batt, American deputy member of CPRB, said, in relating incidents connected with the production of the English-designed engine in this country: "American engineers found that considerable information usually shown on American drawings was not shown on the British drawings. Thus, complete shop notes had to be placed on each drawing and not until the final approved American drawing of the part was completed was it possible to design the parts, dies, jigs, or fixtures required for manufacturing."

Mr. Batt said that the problem was not so much one of redrawing the English blueprints as one of translating the radically different method of depicting what the designer wanted into American terms. Without this the American shop machinists would have found it virtually impossible to fabricate the parts as intended by the British designer.

It has been found that in many British drafting prints, of which perhaps the Rolls-Royce design is a typical illustration, many details that American engineers expected to find were omitted from the drawing because in England great reliance is placed on the craftsmanship of old employees. Moreover, a great deal of hand fitting is done. For United States mass production, however, it is required that every dimension and tolerance be clearly stated on the drawing for the benefit of all who work on the project.

"The United States, Britain, and Canada are still beset by many production problems which we can trace directly to differences in design and drafting practice," Mr. Batt continued. "We are all now aware that these differences must be solved."

Following the exchange of missions of experts between the United States and Great Britain on various standardizations, the CPRB is now sponsoring technical discussions on unifying design and drafting practice.