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Post-War Monetary Reconstruction

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In this address delivered recently before the Office Management Association, Hamilton, Professor Michell, who has contributed numerous articles on economic subjects to Industrial Canada, explains the plans that have been suggested by British, United States and Canadian authorities for setting up after the war a worldwide system of control over international trade and the movement of capital. His article will be enlightening to those who would like to understand the plans that have been advanced by the three countries.

NOW that final victory is not in doubt, however hard the road may be to that goal, even during the preoccupations of war the thoughts of those who will be faced with grave post-war problems are turning more and more to the time when reconstruction will be necessary and the shattered economic system of half the world restored. The disasters that followed the first war are too vividly in our memories to allow us to face a similar period in the future; if the wit of man be sufficient to devise means to avoid it.

After the armistice in 1918 everybody thought that the world's troubles were over and that the nations could turn back to the ways of peace. The devastated areas would be rebuilt, and Germany would pay for the war. Industry and world commerce would be restored and pursue the paths they had followed before. That seemed a very simple solution to all difficulties; we might even say a simple-minded one and it is easy to see now how mistaken we all were. It was a natural mistake; because our generation was inexperienced in so vast a problem. It had never faced anything like it before, and the best brains could no more than guess what lay before them. Of course the greatest error was in supposing that Germany could "pay for the war" and in light-heartedly fixing fantastic sums as reparations. There was not enough money in Germany, nor in the whole world for the matter of that, for these colossal payments to be made, as the victorious nations soon found out. The world was plagued by the aggravating question of reparations and war debts for nearly twenty years. Germany could not pay France, France could not pay Great Britain and at last Great Britain could not pay the United States and recriminations and hard feelings were plentiful. The world's money affairs were in chaos. Germany had inflated and her mark was worthless; all sorts of money was abroad, currencies with strange names that nobody had ever heard of and justifiably distrusted.

Tariff Walls Rise Higher

The only way that Germany could pay anything, and we must at least give her the credit of trying to pay, was by exporting her manufactures and so accumulate balances abroad which she could transfer to her creditors. That was what Germany did; it was all she could do, and the markets were flooded with cheap German articles which undersold the producers of other countries. To protect themselves against this competition, other countries put up their tariffs to keep out this great flood of dumped merchandise. All over the world tariff walls rose higher and higher until international trade was well-nigh strangled. In 1925 the Bank of England, in a magnificent attempt to put the pound back in its former proud place as the international unit of exchange, resumed gold payments. The step was ill-judged and disastrous; the pound sterling simply was not worth its former equivalent in American dollars. Other nations, wiser, or less scrupulous if you like, instead of restoring their currencies to their pre-war gold content as had Great Britain, did the exact opposite. The franc, the lira, the yen were all reduced to a fraction of their former gold value and the confusion became worse confounded. There followed the crash on the stock exchanges of 1929, the onset of the great depression and in 1931 the Bank of England stopped gold payments. In 1933 the United States devaluated the dollar by taking 41 gold cents out of it, and the world, with infinite trouble, began slowly to climb out of the depths of economic disaster. But not for long; the second world war cut across the painful efforts of the nations to re-establish economic order.

Experience of First Post-war Period

Such was the course of economic events after the first war; what will be the outcome of the second? We are going to face a very serious situation, of that there can be no doubt. But grave as it may be, yet we do have one great advantage, we have had the experience, the painful experience, of the first post-war period to teach us, and since nations like individuals learn best in the school of hard knocks, it is likely we have learned a lot.

Let us envisage what we shall see when the war is over. Our enemies beaten, but at a fearful cost. Half Europe and much of the East in ruins with starving, despairing multitudes. The sheer physical destruction of the war is appalling, with great cities, with all their homes and business places and factories, railways and roads, light and water mains, blown to annihilation. Are you going to demand that Germany must "pay for the war" when you have made her great cities deserts? At least we shall not make that mistake again. The first thing we must do is to get the wretched victims fed and clothed and housed somehow in at least makeshift shelters. That will all be a big job but not impossible and will be a passing phase. But, after the immediate necessities have been somehow or other met, the even greater and more baffling problem of getting manufacturing and production going again will confront the world. And without a sound monetary system that will be so difficult as to be next to impossible.

It will be the countries which have not been devastated that will have to restock Europe. That is going to be a hard task, and if the world's monetary system is in confusion, it is going to be an almost impossible job. The absolutely imperative pre-requisite to any rehabilitation of the devastated countries will be a sound international system of foreign exchange. For without that no nation can buy what it needs from another, nor sell to those who seek to buy. Of course, it is easy to see that the problem of the international exchanges is really fundamentally that of the currencies of the various countries. If we can get the pound, the mark, the franc, the lira onto a sound basis, then the international exchanges take care of themselves. It was the violent inflations in Europe and the confusion of currencies that led to the troubles after the first war. The two problems are inseparable and must be treated as one. The one great advantage we possess now is that we clearly recognize that, and our ingenuity will be sufficient to devise means whereby we can put into operation an international system of exchanges that will function for the benefit of all, victors and vanquished alike.

Three Plans Put Forward

Three plans have been put forward, by the British, the Americans, and by the Canadians. It must be emphasized that these are no more than suggestions, put out in order to stimulate discussion and criticism. The British and American plans differ somewhat sharply in one or two particulars of which we shall speak in due course, and the Canadian plan seeks in certain particulars a compromise between the two. All are designed to one end—the provision of machinery so that trade between nations shall be made easier through the provision of machinery whereby the foreign exchanges are kept steady and the impediments of serious fluctuations avoided.

It must first be understood that all plans are temporary. That is to say they are not looked upon as setting up permanent machinery which will last indefinitely. Long term reconstruction, the investment and distribution of capital for development of industry and transportation in different parts of the world do not come within their range. It is hoped, and indeed confidently expected that when reconstruction, partial or at least sufficient to get the devastated areas going again, has been effected, the accumulation of capital and its profitable investment will go forward and make the temporary scheme unnecessary.

All plans contemplate setting up a super-national authority, a kind of World Bank whose directors shall be nominated by the various nations, although of course it is not really a bank, and we must not use that term. The duty of this authority shall be, to quote the British plan:

1. To regulate and manage international currencies and the mechanism of the foreign exchanges.

2. To set up the framework of a common commercial policy for all nations which shall regulate the conditions for exchange of goods, tariffs, preferences, subsidies and import regulations.

3. Supervise the orderly conduct of production, distribution and price of primary products, so as to protect both producers and consumers from loss and risk due to extravagant fluctuations of market conditions.

4. Give aid to investment, both for short and long terms, for countries whose economic development needs help from outside.

In a word, what the various plans intend to set up is a world wide system of control over international trade and the movement of capital. Its aims will be beneficent and in the interests of the countries participating, so far as they do not seriously clash with those of the rest of the world.

The British, American and Canadian plans are highly complicated and to go into them thoroughly is a task beyond the confines of a short address. It is possible, however, to get to their core and, ignoring details, to find out what are the similarities and differences between them. That will mean a rather hasty survey but cannot be helped.

The American plan proposes that the international authority, which it calls the International Stabilization Fund, shall start with a capital of $5 billions, to which each country shall contribute in its own currency, in securities and, if it has any, gold. We might note that the Canadian experts think $5 billions too little and suggest it be increased to $8 billions. The British plan makes no provision for a subscribed capital. It proposes to work on what we may call the banking principle—that creditor countries should accept entries on the books of the central institution as payment for debts owed to them by other countries. For instance, suppose Greece owed a substantial sum to Canada for purchases of wheat or farm machinery. Canada would be paid not directly by Greece but by a credit on the books of the central institution. The latter would be able to grant this credit because it has a sufficiently large surplus from the balances of creditor countries. This is, obviously, the way in which commercial banks carry on their business. They accept savings deposits and lend them out to borrowers. The central authority in the British plan will always have credit balances on its books because every debit will create a credit. If one country buys from another the amount it spends will appear as a debit on its account and as a credit on the account of the country from which it has bought.

A moment's thought will reveal that what the British plan really proposes is that creditor countries shall lend to debtor countries. The American plan proposes that the debtor countries shall borrow from the central fund. It is obvious, therefore, that the American plan is somewhat more rigid than the British, but that fundamentally the practice will be the same. An ordinary commercial bank has its capital and it also has cash deposits. But it lends out much more than both these combined. It is hard to suppose that under the American plan the central authority will be tied down to granting credits only up to $5 billions. It may be remarked that it is not necessary for a central bank to have a large capital. The Bank of England's is quite small, and that of the Bank of Canada only $5 millions.

Quota for Each Country

All three plans lay down a quota for each country as a basis of borrowing and voting power. In the British plan this quota is based on the aggregate of each country's imports and exports. In the American plan the quota is to be based on "a country's holdings of gold and foreign exchange, the magnitude of the fluctuations in its balance of international payments and its national income." The last two are rather vague terms and might be difficult to calculate. It may be said, however, that probably the method of assessing the various quotas can be worked out by either method and substantial fairness arrived at for each country.

British, American and Canadian plans all propose that a new international unit of account be created, backed wholly by gold in the American and Canadian and partially in the British The American plan suggests that this new unit be called Unitas and consist of 137.14 grains of fine gold, that is to pay $10 with gold valued at $35 per oz. and with this the Canadian plan agrees. The British suggest the name Bancor—the names of course are of no importance—this unit to be expressed in terms of gold on a basis to be subsequently settled. But these bancors shall not be convertible into gold, although gold can be converted into bancors.

At this point an important difference between the two plans emerges. The gold content of the unitas can only be changed by a vote of 85 per cent of the member votes. The bancor is more flexible and its weight must be determined when the plan is to be put in operation. No specific weight is suggested, and that weight is not to be invariable. If it is found from experience to be too light it may be increased, or vice versa. The reason for this is apparent. The bancor is to be a real international currency with transfer of that unit on the books of the international authority. The basic idea of the American unitas on the other hand is that it is merely a measure, or a unit of account. The accounts of the International Stabilization Fund are not to be kept in unitas, but in pounds in London, dollars in the United States and francs in Paris. So many francs in Paris or marks in Berlin would mean so many francs or marks valued in unitas. In other words, it is an arithmetical device used for adding up all these different currencies. It is not an international currency, while the bancor is.

The Position of Gold

As we have just said, both bancors and unitas are based on gold, the unitas very closely, the bancor less so. It should be particularly noted that the British plan anticipates that gold should be supplanted as a governing factor. The paragraph in the White Paper which speaks of this intention is worthy of close attention.

"Gold still possesses great psychological value which is not being diminished by current events; and the desire to possess a gold reserve against unforeseen contingencies is likely to remain. Gold also has the merit of providing in point of form (whatever the underlying realities may be) an uncontroversial standard of value for international purposes, for which it would not yet be easy to find a serviceable substitute. Moreover, by supplying an automatic means for settling some part of the favourable balances of the creditor countries, the current gold production of the world and the remnant of gold reserves held outside the United States may still have a useful part to play. Nor is it reasonable to ask the United States to demonetize the stock of gold which is the basis of its impregnable liquidity. What, in the long run, the world may decide to do with gold is another matter. The purpose of the Clearing Union is to supplant gold as a governing factor, but not to dispense with it."

It is not hard to read between the line of the authors of the British plan. They acknowledge the great part that gold has always played and is still likely to play in international dealing in providing as they call it "an uncontroversial standard of value for international purposes." But equally clearly its authors would like, if they only knew how, to get rid of gold altogether. "The remnant of gold reserves" held outside the United States is so small as to place the rest of the world at a grave disadvantage. But "it is unreasonable to ask the United States to demonetize the stock of gold which is the basis of its impregnable liquidity."

It is wholly unlikely that the United States should agree to any plan that envisages the supplanting of gold. We may also surmise that Canada will be very unwilling also; indeed in the proposals submitted by the Canadian representatives the American retention of gold is followed. Nor is it likely that South Africa will be anxious to see gold supplanted. The Russians with their gold mines, which before the war they were developing very strenuously, are hardly likely to view such a proposal with favour.

Question of Exchange Rates

Turning now to the question of exchange rates we must note that all plans say that, when the system is begun, the currency of each country shall be given a value in terms of the new international unit. How then, if at all, shall changes be made in these values? The American plan says that changes will only be allowed by permission of the central authority, that is to say the board of directors shall allow or disallow a plea to change the rate of exchange, shall we say, between the dollar and franc. The British plan would allow much more latitude. If a country has over some years accumulated a debit balance equal to one quarter of its total quota, it may then reduce the value of its currency five per cent. If it continues to accumulate a debit balance up to a sum equal to half its quota then the Central Authority may advise it to lower the value of its currency, control the export of its capital and surrender any gold it may possess.

The American plan is much more direct. It says, "Countries are to agree to adopt and carry out any measure recommended by the fund designed to correct disequilibrium of the country's balance of payments." In the revised American plan a special provision has been made whereby during the first three years of operation adjustments in rates may be made if such are deemed necessary and desirable, but thereafter no adjustments shall be made whatever without a four-fifths majority approval. That during the difficult years when the plan is getting on its feet it will be permissible to make changes is a wise provision. That after that initial period a four-fifths majority will have to approve any change will, to put it frankly, make any change disapproved of by the United States Treasury impossible. The Canadian plan would make permissible the depreciation of a country's currency up to 10 per cent of its value when over a two-year period it has had an adverse balance of payments of such magnitude that to cover this deficit it has used up 50 per cent of its independent gold and foreign exchange reserves and is, in addition, a net purchaser of foreign exchange from the union to the extent of 50 per cent of its quota. A country that under these circumstances wishes to depreciate its currency can only do so once, unless it obtains the permission of the directors of the Union to do so again. In all three plans the intention is the same—to see that manipulation of exchange rates in the interests of a single country at the expense of others shall not be permitted. Devaluations of currencies, the franc, the lira and the yen before the second war led to such confusion and downright sharp practice towards other nations that, without consent of all concerned, they cannot be allowed again.

What it comes to is this. All three plans seek to get rid of control of their exchange rates by individual countries either by revaluation of their currencies or by devices to block their free movement across the exchanges. The latter practice, even more than devaluation, was what was hampering the commerce of the world before the second war. Germany would sell to any country; but once the money in payment got to Germany it stayed there and was "blocked." If a traveller visited Germany he could take money in, but he could not take it out because the government wanted it to buy guns not butter.

The American plan says that any country joining the Union must agree to abandon exchange control and not to impose any in the future without consent of the central authority. The British plan is less explicit and merely says that it aims at doing away with blocked currencies. But again perhaps this is no more than a difference of expression, the British plan saying more gently what the American says more forcibly. In any case the intention is precisely the same.

One thing which must be carefully noted is that the British plan is careful to make provision for groups of countries with special relationships of their individual currencies one to another. This, of course, refers primarily to the sterling area which comprised those countries whose currency was reckoned in terms of Sterling—Great Britain, Australia, New Zealand and South Africa, and also those that had linked their currencies with sterling such as the Scandinavian countries. The British plan is careful to lay down that, if countries desire to continue doing this, they shall be allowed to do so. The breakup of the sterling area would be very much to Great Britain's disadvantage. No such provision enters into the American plan, it simply says nothing about it and we are left to infer that it would be adverse to it.

Important Differences in Plans

We have now outlined very briefly what are the main proposals of the three plans. They are similar in seeking to impose upon the world a super-national authority that shall apply what we may call fundamental banking principles to the management of international commerce. That is entirely to the good and will no doubt win general acceptance. But there are very important differences of which the greatest is in the management of the exchange rates. It is quite clear that the American plan seeks to lay down that there shall be no change of exchange rates except under extraordinary circumstances. The British plan seeks to introduce more flexibility and to work through a process of adjustment that will from time to time iron out the differences that may arise in the rates. The Americans are afraid of competitive depreciations of currencies and that is a very great danger. The British are afraid of too great rigidity, and that also is a danger. Whether a compromise can be achieved on that point remains to be seen.

We have reserved until last a more detailed examination of the proposals put forward by the Canadian experts. It was very fitting that Canada should put forward her own suggestions, since as a creditor nation after the war the whole problem of the international exchanges will be a vital one to her. It was also fitting that Canada, who stands between the two great powers of Great Britain and the United States, a member of the British Empire and yet closely related financially with the United States, should make what may be regarded as compromise suggestions that might conceivably open a path for agreement.

The first point to be noted in the Canadian plan is that it considers that an initial capital of $5 billions, as proposed by the Americans, is too small. It would increase that at the outset to $8 billions, of which 15 per cent would be in gold to be paid in on entry to the union by the participating nations according to quota. Subsequently the union could call upon a participant to advance a further sum, not in gold, equal to 50 per cent of its original quota if the supply of that country's currency should become diminished. That is to say, if a country has a very large excess of exports it may be called on to lend to the fund an amount equal to half its original quota. Suppose Canada had been selling very heavily and not buying much, Canadian dollars would be scarce because there is a large demand for them. If Canada's original subscription to the fund had been $1 billion, she might then be called on to lend $500 million to the fund, which loan could be used to supply Canadian dollars to those who needed them. This simply carries out the well-known principle that if a country is selling more than it is buying it will have to export capital, or else the other countries will not have enough money either to pay their debts or to go on buying.

Secondly, with regard to exchange rates, the Canadian is a compromise between British and American plans. The Canadians fix the same gold content for the international unit as the Americans, while the British do not lay down a fixed gold amount. But the Canadian plan follows the British in allowing changes in the gold content, while the American would make it very difficult.

Canadian Plan More Generous

Third, the Canadian plan is considerably more generous in its provision for the obtaining of foreign exchange by participating countries. A country may purchase foreign exchange up to an amount equal to twice its quota at the rate of 50 per cent a year, provided it does not possess already gold and free foreign exchange to an amount exceeding its quota. It is evident that this provision is aimed at not allowing any country to assume a dominating position and that loans should go to those countries that need them most. A second proviso is that these loans may not be used to finance net exports of capital. That is to say no flights from the franc or the mark shall be allowed. The British plan will only allow borrowings from the central fund up to the amount of its quota, and in any year may not borrow more than 25 per cent. of its quota. The American plan will allow of borrowing up to 125 per cent. of each country's quota. In the Canadian plan, if a country has borrowed up to 50 per cent. of its quota in any year it will be required to sell its free foreign exchange holdings or gold to the Central Fund. The British plan is similar to the Canadian as to the control over borrowings and demand for collateral to be put up if those are heavy. If a country has used up more than 50 per cent of its quota it may be required to depreciate its exchange rate, surrender its gold and free exchange holdings and control its capital exports. If it has exhausted 75 per cent. of its quota in two years it may be declared in default. The American plan is less explicit than the other two with regard to borrowing. It says that restrictions may be imposed on further borrowing if a country is using up its quota too quickly. It may be noted that the Canadian plan would have decisions made by a simple majority of votes not by a four-fifths majority as in the American, thus seeking to guard the rights of the smaller nations. It may also be noted that the latest proposal from Washington to set up as an auxiliary to the stabilization fund a supernational bank would presumably take care of the plea of the Canadian plan for extensive borrowing by the participating nations.

Difficulties in Way of Agreement

Looking now at the field as a whole, what are we to say of it? It is not at all difficult to see where the difficulties of agreement will lie. First, of course, in the question of gold. The American plan demands not only that the unitas be backed wholly by gold, but that the subscriptions to the central fund shall be partially in gold. In the original draft it was laid down that 12½ per cent of these subscriptions shall be in gold. In the revised draft this is made much stiffer and from 30 to 50 per cent. is demanded in gold. That really amounts to asking the participating countries other than the United States to hand over every particle of gold they possess. What is to happen to those countries that have no gold, or very little? There seems to be no answer to that discernible at present. It may be remarked that probably this gold clause, if it is agreed upon, might not bear too heavily upon Canada as a gold producer. But with the greatly increased foreign trade to be expected, it may be feared that even Canada will feel the pinch. That Great Britain will assent to this is hardly to be expected.

At this point it will be pertinent to interpose a suggestion. Would it not be possible to include silver and make it a bimetallic standard? If the ratio of exchange between the two metals were fixed internationally, the hazards of bimetalism would be avoided. Nobody has ever denied that international bimetallism is perfectly feasible. The impoverished countries will have very little gold but a lot of silver. It would help very materially if they were allowed to make their subscriptions partly in gold, if they have any, and partly in silver. It is very difficult to find any objections to this scheme and a great deal can be said for it. It may also be pointed out that in restoring the currencies of occupied Europe silver could play a very important part. It is not hard to imagine what the liberated French will feel towards occupation marks and Vichy paper money. Give them fine, heavy, five franc silver pieces and their confidence in their money will be restored. Already we hear of difficulties with Amgot lire in Sicily. It is entirely unlikely that the British will accept the gold clauses of the American plan. Great Britain made a terrible mistake in 1925 in restoring gold payments, and we may be sure it will not want to repeat it.

The other obstacle in the way of agreement is the problem of special areas, that is to say the retention of the sterling area. Will the countries that adhered to that plan ever agree to relinquish it? Again all that can be said is that it is extremely unlikely. It is pertinent to observe that the Free French have suggested that a system of groups of countries might very well function. During the first year of the war an arrangement was worked out whereby the franc and the pound were linked and worked quite satisfactorily until the catastrophe of 1940.

Is there any insuperable reason why the sterling area should not co-exist with what we may call the dollar area? To the latter Canada would obviously adhere. It might not be at all disadvantageous for Canada to do so.

And lastly, to end this all too brief sketch of the various plans not on a pessimistic but, shall we say, a realistic note. One thing is perfectly clear—no plan can work unless the nations' balances can be put right and quickly enough to keep borrowings within limits. That will be immensely difficult; it may even be impossible. How are these favourable and unfavourable balances to be adjusted? There is only one way, and we may as well understand and acknowledge it frankly. An unfavourable balance can only be adjusted by a nation buying less and selling more, and a favourable balance by a country selling less and buying more.

Canada, the United States have been in the happy position of selling more than they have bought, and Great Britain of buying more than she has sold. If international balances are to be struck these trends will have to be reversed. That is going to be difficult: it may be impossible. But if some workable scheme for managing the international exchanges comes out of the controversy an immense advantage will have been gained. We can but hope that human ingenuity will be sufficient to accomplish this task.