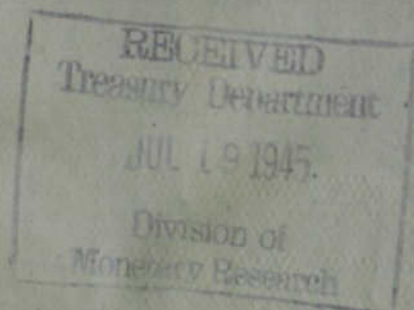


Second Report
OF THE
Federation of British Industries
ON THE
FINAL ACT OF THE UNITED NATIONS
MONETARY & FINANCIAL
CONFERENCE



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SECOND REPORT
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1. In the interim report adopted by the Grand Council of the F.B.I. in November, 1944, general approval was given by the Federation to the Bretton Woods plan.
2. It was pointed out, however, that this approval must not be taken to imply complete satisfaction with all the provisions of the Final Act. There were certain defects to which the Federation attached major importance in estimating the prospects of the successful accomplishment, in the common interest, of the purposes of the scheme. It was proposed to define such defects in a subsequent report after further study had been devoted to them.

ARRANGEMENTS FOR THE TRANSITIONAL PERIOD

3. In the aforementioned interim report the Federation was apprehensive lest the Final Act might impose undue restrictions upon the freedom of the United Kingdom to make special arrangements to deal with the difficulties of adjusting her economic system and balance of payments during the period of reconstruction at the end of the war. In view of the magnitude and complexity of her payments problem, the Federation suggested that a transitional period even longer than the three to five years contemplated in the provisions of the International Monetary Fund might prove to be necessary. It will be recalled, however, that the provisions of the Final Act do not set definite limits to the duration of the transitional period, during which members may maintain any restrictions over their international payments which the circumstances of the period may render necessary. What the Final Act requires (Article XIV) is that, before the completion of the third year of the Fund's operations, a report shall be made by the Fund upon the restrictions still in force and that a further report shall be issued in each succeeding

year. Upon the completion of five years' operations, the Fund shall consult annually with each member which still maintains exchange restrictions on current transactions with a view to their removal as soon as conditions are favourable to such action being taken. According to the terms of the Final Act, a member will not be under compulsion to remove, at any stated time, restrictions which are necessary to the maintenance of its balance of payments during the period of rehabilitation. On the contrary, the onus of proof that such necessity no longer exists rests upon the Fund, which, in making its decision, is required to give the member concerned the benefit of any reasonable doubt. The transitional period, therefore, is not to be of any pre-determined duration but will continue for each member as long as the necessity for exchange controls is found by the Fund to persist in each individual case.

4. In assessing the duration of the transitional period, during the early years of which the current trade balance of the United Kingdom will probably be adverse, it is important to remember that there have accumulated as a result of her war expenditure abroad unliquidated sterling balances which eventually will reach several thousand million pounds, against which this country will possess a greatly diminished volume of external assets. The post-war settlement of these obligations must form an integral element of the establishment of the equilibrium of the United Kingdom balance of payments contemplated under the provisions of the Final Act.

5. In its interim report the Federation recommended that a clause should be inserted in the Agreement to provide for a reviewing conference to be held at a suitable date towards the end of the transitional period as at present defined, "say four years from the beginning of the operation of the Fund." Further study of the Final Act has suggested that the Federation's wishes might perhaps be met by using the provisions of Article XIV—4 set out in paragraph (3) above. Moreover the provisions of Article XVII allow of a review being made on demand by a majority of the governors.

6. These provisions would appear from their wording and context to be somewhat limited in scope; but it is conceivable that they might be so interpreted as to afford an opportunity for what would amount to a reviewing conference, empowered to make recommendations both for modifications in the transitional period, if these should prove necessary, and for such major or minor modifications as might be thought desirable in order to increase the effectiveness of the Fund. Provided that this broader interpretation was generally accepted by members at the outset—and this would possibly require some initiative on the part of H.M.G. at the time of accepting the plan—the Federation would see no urgent reason for pressing that a special formal provision for a reviewing conference be made along the lines of Section 10 of its interim report. There is, indeed, much to be said for flexibility rather than formal commitments in such matters, provided the flexibility is generally understood as being sufficiently wide for the purpose in view.

FIXATION OF RATES OF EXCHANGE

7. Another matter relating to conditions during the transitional period on which the Federation desires to comment is the machinery laid down for fixing rates of exchange. Article XX—4 provides that "When the Fund is of the opinion that it will shortly be in a position to begin exchange transactions" it shall "request each member to communicate within thirty days the par of its currency, based on the rates of exchange prevailing on the sixtieth day before the coming into force of the Agreement." As the Agreement if adopted is to enter into force not later than 31st December, 1945 (Article XX—2(e)) the rates of exchange of currencies such as the pound sterling are likely, broadly speaking, to have to be determined by regard to conditions prevailing at that time.

8. It is, however, far from certain that such parities will prove to be appropriate for post-war world conditions. Unfortunately there are no recognised rules by reference to which, in the largely unforeseeable and inevitably unstable conditions of the transitional period, reliable rates of exchange can be established. Quite apart from the difficulties ordinarily encountered in attempting to compare relative purchasing powers, costs of production and so forth, balances of payments are liable, even in normal times, to be disturbed by underlying changes in world demand, variations in tariffs, fluctuations in interest rates and many other factors. How much more unlikely is it that rates of exchange fixed in war-time, under conditions of closely regulated markets, strict international allocation of supplies, detailed exchange control and distorted costs of production, will prove appropriate to those conditions of freely-moving competitive markets towards which it is the declared object of United Nations' governments to direct their course in the years succeeding the war.

9. In other words, the only test of a true equilibrium rate of exchange between two countries, each engaged in international trade, is the practical test of trial and error. Nothing but this empirical approach can be expected to lead to a satisfactory relationship between the currencies of the members of the Fund. The International Monetary Fund provisions recognise this fact by implication in Article XIV—5 which admits that "the post-war transitional period will be one of change and adjustment." Furthermore, a rate of exchange is not a matter for one country alone; by its nature it affects many countries. While, therefore, the only practicable starting point may be, as the Final Act proposes, to take prevailing rates of exchange, the criterion of changes thereafter must be the practical one of trial and error.

10. The Federation would accordingly like to have it provided that revisions in rates of exchange made under the terms of Article IV—5 in the transitional period should be without prejudice to the subsequent exercise in the post-transitional period of members' rights of revision as provided in that section. This would mean that any revisions in rates that had been found necessary in the transitional period would be additional to those provided for under Article IV—5.

THE STERLING AREA

11. It is not clear what effect acceptance of the Final Act would have on the concept of a sterling area. It is crucial to observe that this concept is not something which has been subject to statutory demarcation (with the exception of purely administrative lists of countries for the purposes of the British war-time exchange control). As an operative concept distinct from the gold standard the "sterling area" emerged in 1931. The area consisted, in addition to the United Kingdom, of a group of countries (practically all other British Dominions and territories except Canada, together with certain foreign countries) which by their own laws or by mutual consent, based on long tradition and close trading relations and borrowing facilities, maintained reasonably permanent relations between their separate currencies, ordinarily by reference to the pound sterling, and held their monetary reserves (apart from gold) mainly in the form of sterling. Even now, with exchange controls in full operation, most of the payments arising within the sterling area (diminished as a direct result of war) are made substantially without restriction, in the expectation that the aggregate of visible and invisible trade movements will support that freedom through an approximate equilibrium of the balances of payments of members with one another over a period of years.

12. The concept of the sterling area carries with it no implication of an exclusive policy in international trade or finance; nor has it any necessary connection with an international quota system, imperial preference or any "closed" trading area. It is not a device for the exclusive benefit of British export trade, nor does it involve the use of the purchasing power of the countries concerned to force other nations to buy from them. Within the sterling area each country issues and controls its own currency and it is a misapprehension of what the sterling area means, and indeed, a failure to understand the political structure of the British Commonwealth, to conceive that area as one in which London, as a banker, issues a currency for the whole area merely as a token for the purchase of goods within that area and under restrictions and limitations imposed by Great Britain.

13. The mainspring of the sterling area is the practical convenience of day-to-day business and the economic stability of the individual members, but its long operation has brought about a closer relation and understanding in monetary matters between the countries concerned. The monetary conduct of members is neither dictated to them nor influenced, except in so far as knowledge of the facts and good sense show the desirability of achieving as nearly as possible a balance of inter-country payments, coupled with the recognition that any debts between them can only, in the long run, be discharged through a balance of goods and services passing from the debtor to the creditor.

14. The Final Act of Bretton Woods provides the international mechanism within which each member may pursue the internal monetary policy best suited to its requirements. This is the exten-

sion on a world scale of the principles which governed the operation of the pre-war sterling area. There does not appear to be any antagonism, therefore, between a sterling area and the objects of the Fund; and, provided that on the expiration of the transitional period the currencies of members of the sterling area are freely convertible in accordance with Article VIII, Sec. 2, its continuance does not appear to conflict with the provisions of the Final Act as set out in the text. This concept of the sterling area operating within the ambit of the Fund must not be taken as implying that the Federation accepts the alternative of the sterling area as preferable to the Fund. On the contrary, they consider that one of the advantages enjoyed by the Fund over that concept is that it offers the possibility of putting into practice the same principles which actuated the sterling group, but over a very much wider international area. Moreover the changes in the relative economic positions of the several countries which have been brought about under the stress of war would present obstacles to the operation of a sterling area as a separate and perhaps competitive system, vis-a-vis the Fund. Under such circumstances, many countries would be placed in considerable difficulty in deciding where the balance of advantage to themselves would lie. Other potential members would be clearly precluded by their own interest from adhering to such a competitive system.

15. The Federation is convinced that only if agreement upon the more universal system is found to be impossible should the consolidation and extension of the sterling area be made the dominant objective of the external monetary policy of the United Kingdom.

LONG-TERM PROVISIONS

16. As explained in its interim report, the general approval given by the Federation to the broad objectives and principles of the Monetary Fund and the International Bank must not be taken to imply approval of the Final Act in all its details. Not only does it contain a number of ambiguities of definition and phrasing but it suffers from certain defects, mentioned below, inevitable in a document which had to be drafted in such a manner as to reconcile the varying shades of opinion encountered in a gathering of representatives of some 44 nations.

ALLOTMENT OF QUOTAS UNDER THE FUND

17. The Final Act provides for the allotment of a quota to each of the members of the Fund, but, in the computation of such quotas, little regard appears to have been paid to the underlying economic facts relating to the several members. Experience of the working of the Fund may demonstrate the unsuitability of the proposed scale of quotas. The plan, however, provides facilities for reviewing the quotas in the light of experience, though under Article III-2 any revision requires a four-fifths majority of the total voting power.

ABSENCE OF DETERRENTS ON PERSISTENT SURPLUS COUNTRIES.

18. The facilities for purchasing foreign currencies from the Fund are to be available to any member with a current adverse balance of payments provided the proceeds are used in accordance with the purposes of the Fund, but progressive charges are to be imposed to act as a deterrent to countries making a heavy or prolonged use of the Fund's resources. In the opinion of the Federation, the absence of any deterrent upon persistent surplus countries, such as, for example, the interest charge upon credit balances, as recommended in the original Keynes Plan, is a matter for regret.

19. The provisions of the Final Act applying to surplus countries in general moreover reveal a strong shift in their favour from the proposals in the Joint Statement of Experts in April, 1944. This finds particular expression in the enlargement of the voting power of these countries on a question of "waiver" or of debarring a member from access to the facilities of the Fund (Article XII—5(b)); the imposition of progressively deterrent charges in respect of the use of the Fund (Article V—9) and the disappearance of any corresponding deterrent such as that mentioned in paragraph 18 above; and the more stringent procedure laid down in Article VII for the declaration of a currency as "scarce," together with provisions for the immediate suspension of unilateral counter-measures as soon as the Fund has declared a currency no longer scarce.

WEIGHT OF AMERICAN INFLUENCE

20. The United States has the largest quota in the Fund and is allocated 28 per cent. of the total number of votes. It is thus in effect given a sole power of veto over any proposed modification of the Agreement (Article XVII (a)); over any proposal to alter a member's quota (Article III—2); over changes in the scale of charges on debts to the Fund (Article V—8 (e)); and over possible additions to the number of executive directors (Article XII—3 (b)), since any alteration under these heads requires 75 or 80 per cent. of the total number of votes. Under Article XIII—1, moreover, the headquarters of both the Fund and the Bank have been placed in the United States. Special responsibility will therefore rest upon the United States if the Fund, which is a complicated mechanism requiring liberal interpretation and operation, is to function smoothly and fulfil its purpose.

21. No less important is the responsibility attaching to the United States, as the world's greatest consumer and source of capital, exercising a decisive influence on world trade, to show wise statesmanship both at home and abroad in its economic, commercial and financial policies. Unless the United States in common with the other major powers acts in these matters with a keen and consistent sense of its responsibility to the rest of the world, the foundations upon which the plan rests will be jeopardised.

22. The Federation has some misgivings as to the wisdom of the present provisions whereby the headquarters of both the Fund and the Bank are to be located in the United States. It would prefer to see the headquarters of the Fund, at least, placed in a country of relatively small importance, judged by its influence on world financial and economic conditions. If such a change in the plan should prove to be impracticable at this stage, the Federation would express the hope that the situation of the headquarters might be fixed only tentatively and that at an appropriate moment H.M. Government would act upon the statement (Cmd. 6597) made by the Delegation of the United Kingdom at the time of the Bretton Woods Conference :

“ In the opinion of the British Government the location of headquarters of the Fund ought not to be considered without reference to the location of other international bodies which will be established. The same observations apply equally to the location of the projected Bank for Reconstruction and Development. The British Government may therefore find it necessary at some later date to ask that all such inter-related questions should be considered as a matter for decision between Governments rather than in a technical conference.”

23. It must be emphasised, however, that the successful operation of the plan cannot be guaranteed by any meticulous distribution of influence or authority within its management. The exercise of such influence by any leading member or group of members in pursuit of national or sectional advantage would defeat the purposes which the Bank and the Fund together are designed to serve. Power within the plan will carry proportionate responsibility for its successful working and the realisation of this responsibility by all participants is the only foundation upon which its practical success can be assured.

[Upon the general question of common responsibility, the Panel feel that the following extract from the findings on Commercial Policy made at the Rye Business Conference is particularly appropriate to the discussion of the Bretton Woods proposals :

“ It is essential to emphasise that a sound commercial policy is closely dependent on a satisfactory solution of the question of each country's international solvency. The decisive influence on world trade exercised by the level of economic activity in the major industrial countries deserves increasing attention. Prosperity or depression in those countries is all pervasive. A particular responsibility, therefore, rests on them to curb the undue fluctuations which have hitherto characterized their economies.”

The Rye Business Conference was held at Rye, New York, in November, 1944, and was convened jointly by Chamber of Commerce of the United States of America ; International Chamber of Commerce, American Section ; National Association of Manufacturers and National Foreign Trade Council ; and the Federation of British Industries was represented there by the President and Sir Peter Bennett, with Mr. Glenday as adviser. Representative business men of 52 nations attended.]

MEANING OF THE TERM " FUNDAMENTAL DISEQUILIBRIUM "

24. The Federation has been seriously concerned regarding the omission from the Final Act of any definition of the condition of "fundamental disequilibrium," by reference to which changes of the par value of currencies are to be decided. As the result of efforts to define this condition, the Federation realises how difficult it is to offer a definition which would be uniformly satisfactory when applied to disturbances of the balance of payments which may arise from quite different causes. It appears that the practical interpretation of "fundamental disequilibrium" will have to be left to the wisdom of the management of the Fund who, in judging an application, will have the benefit of full knowledge of the current trends of trade and of international payments. Also it must not be forgotten that, under such authority exercised by the Fund, the internal economy of the deficit member would be safeguarded by the provision (Article IV —5 (f)) that the Fund shall not refuse an application for relief because of the social or political policies of the member concerned.

PROVISIONS FOR INTERPRETATION AND MODIFICATION

25. Article XVIII of the Final Act provides for any question of the interpretation of the provisions of the agreement to be submitted to the Executive Directors, with an appeal to the Board of Governors. These interpretation clauses might well provide suitable machinery for the emergence of administrative modifications of the provisions of the plan. Article XII, Section 8, provides that the Fund has the right at any time to communicate its views informally to any member, and therefore to all members, on any matter arising under the Agreement. It would therefore seem that it might prove possible to use this machinery to secure in the process of time modification of the plan in certain of the directions recommended earlier in this report, without the necessity of summoning a conference of the subscribing nations.

THE INTERNATIONAL BANK

26. The purpose of the Monetary Fund is to ensure greater stability in the conduct of short-term or current trading transactions. The International Bank for Reconstruction and Development is concerned with the international flow of long-term capital with particular reference to :—

- (a) Affording assistance to countries which have suffered from the war (help in reconstruction and reconversion) ;
- (b) Fostering the development of backward countries ;
- (c) Conducting its operations with due regard to the effect of international investment on the business cycle.

The Bank's capital will be \$10,000 million, of which \$9,100 million will be subscribed forthwith ; but of this only 20 per cent. is to be paid up or subject to call. The balance of 80 per cent. uncalled liability is to be utilised where necessary to implement guarantees made by the Bank of loans issued on the market or

placed with the private investor or as cover for borrowings by the Bank. The 20 per cent. paid-up can be used for direct loans by the Bank but the utilisation of the greater part of the Bank's resources, viz., 80 per cent. by way of guarantee, emphasises the importance attached to the part to be played by private capital. Since the Bank's guarantee will only be called upon to meet a default in the annual amortisation and interest payments, this 80 per cent. may be regarded as a very substantial guarantee fund. It is important that, whatever form the assistance rendered by the Bank may take, the approval of the country whose currency is denominated or raised will have to be obtained. Once that approval has been given, the borrower may use the proceeds to purchase goods in any country always provided that the use of the proceeds is confined to the purposes for which the loan is granted (Article III—5).

International lending has always served an essential purpose in helping to raise productive capacity and standards of living, thus promoting expansion of total demand and international trade. The Bank therefore is to be welcomed, and the Federation is of the opinion that it should fulfil a most useful function by catering for the needs of the post-war world in cases where private lenders will be reluctant to assume unaided the risks involved. It would do so, moreover, in a manner that would hold out special advantage to the industry and trade of the United Kingdom, having regard to the prospective limited capacity of this country, for the time being, to resume its traditional role of financing large, long-term capital projects overseas.

PRESENT POSITION OF THE FINAL ACT

27. Since the Federation issued its interim report last November there have been certain changes in the political background of the plan of which it is necessary to take account. The most important of these is that the Final Act is now before the U.S. Congress. Clearly the acceptance or rejection of the plan by Congress cannot fail to influence opinion in other countries. The Federation has carefully reviewed from this aspect the various recommendations made earlier in the present report. It agrees that should it ever come to be a question of having to decide whether to accept the Final Act as it stands—leaving it to the good sense of those who are to operate it to take the steps necessary to remove defects by the machinery therein provided—or to reject it outright, it would recommend acceptance. The following are some of the reasons which have led them to this conclusion.

28. The Bretton Woods plan represents the first essay in the formulation of a post-war system of international co-operation deliberately designed to promote an orderly expansion of world trade on a multilateral basis. Its promise of success lies largely in the circumstances that the background of its operations will be a regular and continuing compilation on a world basis of information

in regard to financial and economic trends in all the participating countries with, however, a very proper safeguard (Article VIII—5 (b)) against disclosure of the affairs of individuals and corporations. This should help to make possible the initiation of corrective action, wherever conditions render this necessary, long before acute crises of the kind which disrupted world trade in the inter-war period are given time to develop. In the second place, the operations of both the Fund and the Bank should assist in the early restoration of that freedom of individual initiative and enterprise upon which the achievement and maintenance of a condition of full employment and rising standards of living in the different regions of the globe must continue in the main to depend. That freedom, moreover, has a direct interest for British manufacturers and traders, since it offers the best prospect of reducing to a minimum the scope and stringency of exchange control, which otherwise might need to be both wide and detailed in its application, and the active official "direction" of exports which might otherwise prove inescapable. In the third place, the plan provides the only practicable alternative to a resumption of the policies of contraction and bilateralism which so many countries were driven to adopt by international dislocation of the inter-war years. In making the above observations the Federation is fully conscious that the machinery of the Final Act of Bretton Woods, however well constructed and intelligently operated, will require to be supplemented by international action in the commercial and cognate fields, if its aims and objects are to be realised to the full.

CONCLUSION

29. The way to a restoration of a system of freely-working multi-lateral trading does not lie through the meticulous elaboration of complex rules and procedures. The price of economic welfare is not so easily discharged. It calls, not for the perfection of formal agreement but for a process of adjustment, compromise and co-operation between those in whose hands will reside the power to produce it.

30. The Final Act of Bretton Woods is not immutable. As the years pass it will doubtless have to be modified and adapted to meet changes in circumstances and the world environment. Meantime the countries of the world should be encouraged to look beyond the welter of current discussion and consider what contribution to the general task they themselves can make, and will be required to make. It is in this spirit that the Federation has reached the conclusion that even if the United Kingdom is unable to secure, at the present stage, all the amendments and modifications of the proposals of the Bretton Woods Conference that it would desire, the Federation, nevertheless, as in its Interim Report, would continue to support the broad principles of the Final Act in the event of the Final Act being approved as it stands by the Congress of the United States of America.