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INTERNATIONAL CURRENCY GOLD versus BANCOR OR UNITAS

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R. PRESIDENT, GENTLEMEN, AND FRIENDS OF THE CHAMBER: I remember one thing with pleasure about the time when I became a member of this Chamber. That was the sponsorship. I was at that time the Economist of the old National Bank of Commerce. James S. Alexander, president of that institution, sponsored my membership here and A. Barton Hepburn, of the Chase Bank, seconded the nomination. I feel proud today of that sponsorship in this Chamber.

It was before I went to the Chase Bank—but by the way, there was an inadvertence in your statement which I want to correct. I was with the Chase Bank from 1920 to 1939—nineteen years—before that, two years with the Bank of Commerce.

I began this study of post-war foreign exchange stabilization about the end of January 1919, and I want to tell you about the studies forced upon us in the years 1919-20, because they are tremendously significant as giving the basis for interpretation of the proposals of the Keynes and White plans.

We had a startling figure for exports from the United States in January 1919, with a balance of trade, I think, of 410 million dollars. That trade balance ran up—it reached 635 million dollars in June. This great volume of goods going out reversed the business reaction that had started with November, the Armistice, and turned business up about March into the beginning of a great boom.

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What was doing it: Well, we were, for four months after the Armistice, advancing money from the United States Treasury which was being used in pegging the foreign exchanges — precisely what these plans propose — francs and lire, but above all sterling.

And seeing the immense volume of exports and seeing the immense strength of those foreign exchanges, I looked into it rather carefully. I had as my tutor a man whom I shall always feel great affection for, Franz Meyer, the foreign exchange trader of the old National Bank of Commerce—a very good trader, a man who knew foreign exchange, who got for me information from various of the other foreign exchange men.

On March 20, 1919, J. P. Morgan & Company suddenly unpegged sterling. They had been buying all the sterling offered, with dollars provided by the British Government, borrowed from the United States Treasury. They unpegged it.

I remember Franz Meyer that day coming into the officers' lunchroom of the Bank of Commerce, his face very grave. It was a stirring day in the foreign exchanges. And somebody expressed sympathy about the sterling picture. He said, "Yes, it is grave. It is serious, very serious."

But I didn't think Meyer was as unhappy as he seemed to be and I ventured a question: "What is our position, Mr. Meyer?" And he answered, his face lighting up: "We are short." He had had no illusions.

Well, that afternoon—I am going to take a little time for this episode—I watched him. I think he had ten telephones on his desk—maybe only eight.

"Yes, yes, I buy \$4.26. Yes, I sell \$4.29."

Then he looked at me and grinned. "I make \$1500."

He was a very good trader!

But the market was full of all kinds of disorder for a day or two until something like a level could be established. And he and other men, buying at \$4.26 and selling at \$4.29, were bringing order into it.

And don't let anyone tell you that the Trader who makes a profit in a wild foreign exchange market is doing anybody any harm. He is doing good. The bid and asked prices would have been very much further apart if he had not been there trading.

We spent billions of good American dollars in direct pegging of foreign exchanges. I say billions—let's get the figure rather exactly—something less than three billions altogether from the Armistice down to June 30, in relevant Government advances, in pegging, and in supporting, after the pegging stopped, the foreign exchanges and the export trade on the basis of it.

Then I expected that the export trade would have to drop pretty soon. I thought those foreign exchanges could not stand the strain. The Continent of Europe was going pretty badly to pieces—unbalanced budgets, printing more bank notes. I thought that the pressure on those exchanges would bring the thing to an end sooner than it did.

Foreign exchanges did go down, but here was the anomaly: sterling went with the continental exchanges. And England was the one country over there, of the belligerents, who was improving her financial position—balancing her budget, working towards the resumption of gold payments. The thing was anomalous.

Then late in the autumn it began to be pretty clear what was happening. When our Treasury stopped, London stepped in. Britain interposed her immense credit, her immense financial prestige, between us and the weak Continent. They were buying goods here, giving us sterling, giving us dollar obligations, selling them on the Continent for francs, for lire, for drachmae. And then as we sold goods on the Continent for francs and lire and drachmae, we did not keep them. We sold them in London. London was the great center for all kinds of speculation. If you wanted to sell anything, you could sell it there.

But this time they got stuck. They bought all the drachmae, all the lire, all the Belgian francs, all the French francs, the depreciating exchanges that we created here through exports. And the strength of sterling had been bending, yielding, but sterling carried on that boom for another year.

Private creditors on this side, taking sterling, taking dollar obligations of England, giving also open account credits to the Continent, put up another three and a half billions.

Then we got fed up and our ability to give credit became restricted, and the thing crashed. We went through the great crash of 1920-21.

If we had had a reaction in 1918, when we were braced for it, it would not have done much harm. Everybody was braced for it. By 1920 a great many people had come to accept the idea of a permanently higher price level. A great volume of credit had been extended against commodities at high prices. Immense real estate speculation had taken place—great increase in farm debt for speculative purchase of farm lands. We were not in good shape for a reaction, but we went through it.

And meanwhile this six and a half billions we had given Europe—three billions from the Government and three and a half from private creditors—did no good. Europe was in far worse shape at the end of 1920 than she was at the beginning of 1919.

The point was that the Finance Minister of a European country, faced with pressure from his people—returning soldiers wanting pensions, wanting pay, people wanting food, pitiful, nobody willing to be taxed, nobody willing to buy bonds—he was taking the easy way, he was leaning on the state bank of issue, he was printing bank notes and more bank notes. And as long as the foreign exchange market would take the paper money which he created, his people could bring in food and luxuries from outside.

We sold them a lot of luxuries in 1920. We sold them everything but the raw materials they ought to have been using to work up and send back.

There was no industrial revival, there was no financial reform in Europe while this thing went on, while we gave an artificial support to foreign exchange.

Now, it is precisely this kind of thing that the Keynes-Morgenthau Plan wants to do—to put the dollar behind the weak exchanges and support them, keep them pegged, so that goods may be sold, exports go out. We will have another boom—a very wild, unsound boom. We will get fed up after a while with pouring so many dollars into that great international machine that they propose. We will pull up and cut our losses, and have a crash.

This folly—our own Treasury, I think, has no financial recollection of this episode; Mr. Keynes has. And I want to read you a little passage from the Keynes Plan which shows you that he has. The episode was pretty costly to England. She had stood in between us and the Continent.

The Keynes Plan, Section 14, says, as an argument for the plan:

"This would give everyone the great assistance of multilateral clearing, whereby (for example) Great Britain could offset favourable balances arising out of her exports to Europe against unfavourable balances due to the United States or South America or elsewhere. How, indeed, can any country hope to start up trade with Europe during the relief and reconstruction period on any other terms?"

Very nice!

If we had had the Keynes-Morgenthau Plan in operation in 1919, England could have bought goods here, sold them at a profit on the Continent, paid for them by putting francs, lire, drachmae into the International Exchange Fund, while we got credits in that fund, and England, by remaining net debtor to the fund, would have had her profits free and clear, and we would have had big credits in an international fund composed of deteriorating drachmae, lire, francs and so on,.

I don't propose to advocate that measure.

Now, I take it that there is general knowledge of the nature of these plans, and there is not time for me to explain the technical details of them. The big thing that they propose is to put the strength of the strong currencies behind the weak currencies to peg the exchanges. And we did it, we tried it; it was no good. We must not do it again. We wasted six and a half billion dollars doing it the last time.

Now, what is the right way to do this thing?

First: The thing we did last time—gifts for the weakest countries; Red Cross or the kind of thing that Governor Lehman is expected to do—but gifts, not loans. Don't call it loans. Don't expect to get the money back. Wipe it off. Limit it to what is essential. Most of it ought to stop after the first harvest after the war.

And even as you make those gifts, make demands upon the governments of the countries that receive them that they get their financial houses in order. Gifts, as well as loans, should do the recipient permanent good.

But, second: Stabilization loans—tens of millions to two or three hundred millions at the maximum, not the billions proposed by these plans—conditioned on drastic internal financial and currency reforms, conditioned on foreign supervision of the use of the proceeds of the loans.

SOME HISTORICAL PRECEDENTS

Now, here we have historical precedents of a very definite sort. We did that for Austria in 1923. We straightened Austria out. We gave her a good start and the Austrians began to pull up from there.

We did it for Hungary in 1924 and we sent Mr. Jeremiah Smith, of Boston, over to sit on the lid, to countersign checks, to see that the money was used properly.

We did it for Germany in 1924 under the Dawes Plan—two hundred million dollars. That was the biggest of these stabilization loans. There was foreign supervision both of the Reichsbank and of certain of the revenues. Germany started right up into a dramatic industrial revival.

We did it for Poland in 1927—seventy-two millions, as I remember. The loan would have been a little bigger if I had not been critical. I did not want to make any more foreign loans at that time, but for some reason the Bank of England was said to have wanted my approval of it, and I carefully examined the figures. I was not satisfied with the figures on the floating debt of Poland and insisted on more information. I finally concluded that they were borrowing too much to use in buying silver for coinage. They had been so sick—their people—of a very inferior, shoddy silver coin that they wanted

to give them a very fine silver coin. I persuaded them that the standard of the Swiss franc was good enough, and then took that difference off the face of the loan before I gave my approval.

Well, we put the Honorable Charles S. Dewey, who was in the United States Treasury, over there in Poland to supervise that loan, to countersign checks, to see that it was properly used. It worked: stabilization of currency, balanced budget, it straightened out.

I want to put in parentheses here that I spent Monday night with Mr. Dewey, who is now Congressman from Illinois, working from about six-thirty until one-thirty, going over a bill that he has since introduced, a copy of which I have, designed to provide a way whereby our Government can cooperate with other European governments or can cooperate with investment bankers in this country, or other countries for that matter, and go in on joint account up to 50 per cent of credits.

That is a very modest sort of thing as compared with that 10 billion-dollar bank Mr. Morgenthau wants to establish for investment purposes.

Dewey's bill calls for half a billion as a revolving fund. And as it is going to be used on joint account up to only 50 per cent, another half billion would be called for from the other participants in the credits. But you don't need more for these stabilization loans, if you see to it that they accomplish their purpose.

I won't go into the details of this bill, Mr. President, but I will say that I endorse this bill. And I am going to venture this request, that you refer it to an appropriate committee of this Chamber for study.

Let me describe the bill for the record. It is House Joint Resolution No. 226, "to provide for central reconstruction fund" and so on, introduced by Mr. Dewey, February 1, 1944, referred to the Committee on Foreign Affairs.

That German loan of 200 million dollars looks very small today, but it was amazingly effective. Germany got no benefit from it directly. The German budget was not relieved by it. The German Government could not spend it for domestic purposes. The German Government got 200 million dollars of gold which it put into the Reichsbank as a gold reserve. Then the German Government got from the Reichsbank, in exchange, 800 millions in marks. But it was obliged to use all of that 800 millions in marks in buying goods in Germany for delivery in kind on reparations account: coal and other things. And it was obliged, moreover, to find, that year, 200 millions more, so that none of the proceeds of the loan could be used for internal affairs.

If there had been no reparations problem and if Germany had been able to use, under the supervision of the creditors, that 800 million marks in putting working capital into the industries and perhaps some measures of relief, the thing would have been far easier.

But just the stabilization of currency got them back to a sound gold currency forthwith. They had been through a welter of inflation—money sinking, sinking; everybody losing confidence and hope. Just the sound currency and the balanced budget, themselves, were business-energizing factors. Business started right up, production started right up, full employment came about.

They were pretty helpless when that thing started. There was a desperate shortage of working capital. That shortage of working capital with other complications led to a sharp reaction in the winter of '25-'26; but there was prompt recovery. The thing went on strongly until '29—early '29. Then troubles began to come.

Germany would not have had these troubles, Germany would have pulled through and the stabilization would have lasted, had it not been for the complication of reparations.

Now, Germany is a special case after this war, of course. Investment bankers to whom I have talked say, "No, we won't sponsor any German bonds. We are not probably going to sponsor any Italian bonds. But bonds for Denmark, bonds for Norway, bonds for France, bonds for England—yes, we can do that, under the proper conditions."

Now, these conditions, to my mind, involve definite agreements about stabilization of currency on a gold basis.

NEEDED LEGISLATIVE ACTION

THERE IS GOING TO BE NEED for some legislative changes in this country before our investment market can work right, either at home or abroad. We must repeal the Johnson Act, of course, before we can lend to foreign governments.

We ought to change one of these very humiliating provisions of the Securities Act, requiring a foreign government, in the prospectus which it signs, to confess repudiation. The bankers sponsoring such a loan ought to put that fact into the record, of course, but it is a little humiliating to ask a foreign government to submit to the Securities and Exchange Commission a statement like that and perhaps to have to revise it six or seven times to fit the wishes of the Securities and Exchange Commission. There is need for the legislation to be changed with respect to that as a matter of international good feeling.

But for either foreign or domestic freedom of American capital, in either foreign or domestic use, I think we have got to go further.

New capital for domestic purposes through the securities market is very difficult to get—there are tremendous hurdles. Since the Securities and Exchange legislation has been in existence, we once got up about 50 per cent of new issues, as compared with 1923, in a part of 1936 and 1937, but most of the time it has been under 19 per cent of 1923. I don't make the comparison with the boom years and the wild years of '24 to '29.

I recommend the abolition of the Securities and Exchange Commission. I recommend the substitution for that of a Securities and Exchange Division of the Department of Justice, which shall not work in detail with every transaction, but which shall punish, under criminal law, violations of the Securities and Exchange legislation—certain criminal law.

There is no more reason for the detailed regulations of the Securities and Exchange business than any other legitimate business.

I recommend that there be created in the Department of Commerce a purely ministerial body to receive registration statements and prospectuses, so that there may be a responsible document, on the basis of which a man may be sued if he has misrepresented or omitted essential facts, on the basis of which a man may be put in prison if he has done the wrong things, made the wrong statements.

We have got to do that or something like that to get our securities market free for either foreign or domestic post-war purposes.

Now, one thing that I would emphasize in connection with the measure of Mr. Charles Dewey is that the board is a purely American board. The Keynes-Morgenthau plans and Mr. Morgenthau's investment bank—both have an international board in control. All three have an international board in control.

A bank, a majority of whose board of directors is made up of debtors to the bank who want to borrow more money, is not a safe bank. That feature alone of these three plans would damage any sound plan, I think. The lenders should control, not the borrowers, in a financial institution.

Both of these plans, the Keynes Plan and the Morgenthau Plan, propose to monetize the bad debts which England owes to the outside world. England, following Mr. Keynes, allowed sterling to get into a very perilous state. It ceased to be gold. It became paper—fluctuating paper, with not even a promise to be redeemed. The irredeemable paper was treated as a "thing-in-itself."

Parts of the world followed England in that—in the belief that you can do that. But sterling got to a very perilous state. And the war broke out.

Everybody wanted to get rid of it; they blocked it. You cannot even sell it now. It is blocked.

The balances are very great and they are growing. In the middle of August, the London *Economist* set them at over a billion pounds—around 4 billion dollars at the official rate of sterling. But added to that, the part to India is increasing alone at the rate of 300 million pounds a year.

Well, if after the war England tries to restore a free pound, lets people sell their claims on London in the open market for what they will bring, sterling will go very low.

And so the Keynes Plan proposed a sleight of hand by which all this blocked debt would be put into the international fund, and the Morgenthau Plan worked out details. It is to be put in there for 23 years and no payments made for three years, and after that 2 per cent a year for 20 years.

Meanwhile England's creditors would have credit with this fund for cash, bancor in the case of the Keynes fund. We are not sure in the case of the Morgenthau fund, because we are not sure if that institution will have deposits or not. They don't say anything about their liabilities.

Well, that is no way to help England.

The Federal Reserve Bank of the World ought not to take debts that people cannot pay into its portfolio and hold them for 23 years and create money against them. That is pretty bad.

We must help England, yes, but the way for England to help herself is to make a settlement with each of these countries that they owe separately—the most of them in the British Empire, the biggest part—and then come to us for four or five hundred millions which they will use in making payments to them, giving them some cash and some long credit—work things out as an embarrassed debtor usually does with his creditors. We will help with some cash and she will get that cash on much better terms here, at a much lower rate of interest, if she will definitely go back to gold—fixed gold sterling. I think she has got to do that anyhow in her own interest.

We cannot afford to stay with Mr. Keynes any longer.

GOLD REMAINS THE STANDARD OF VALUE

GOLD REMAINS THE INTERNATIONAL STANDARD of value, despite the efforts of governments to substitute irredeemable paper for it, because in the last analysis neither men nor governments will trust anything else. The Tripartite Agreement, involving the United States, Great Britain and France, which immediately preceded the collapse of the gold bloc in late 1936, did not

substitute paper dollars or paper pounds or paper francs for gold. The governments did not trust one another enough for that. If in the course of the day's trading in the foreign exchange market, any government accumulated a sizeable amount of another government's currency, the differences were promptly settled in gold.

GOLD AND PAPER MONEY

GOLD NEEDS NO ENDORSEMENT. It can be tested with scales and with acids. The recipient of gold does not have to trust the government stamp upon it, if he does not trust the government that stamped it. No act of faith is called for when gold is used in payments, and no compulsion is required.

Men everywhere, governments everywhere, and central banks everywhere are glad to get it. When paper is offered instead of gold, it will be accepted on faith if the government or the bank which has issued the paper has proved itself worthy of confidence by a satisfactory record of redeeming the paper in gold on demand. If there is a suspension of gold payments, the paper will still be taken on faith, at varying degrees of discount, so long as there remains a general expectation that the government or the issuing bank will some day make good its promise. The amount of the discount will vary in a free gold market or in a free foreign exchange market with the circumstances that make it more or less probable that the government or the issuing bank will make good its promise, and with the circumstances that govern the probable time of the redemption.

IRREDEEMABLE PAPER AS AN INDEPENDENT STANDARD

GOVERNMENTS AND LOYAL PEOPLES have often been quite unwilling to look upon their irredeemable paper money as merely dishonored promissory notes. Always in times of currency disorders there arises the doctrine that "a pound's a pound" and not merely a promise to pay gold coin of fixed weight and fineness. There is believed to be some magic in governmental authority that can make something out of nothing. The prestige of a long established and powerful government is very great. The habits of the people in accepting the long established currency tend to sustain its value. The legal tender quality of paper money aids in holding it up, since creditors must take it in payment of old debts, even though they may try to avoid having to take it when new debts are created. When a currency which has had world wide prestige as long as the pound sterling has, starts on a downward course, it is difficult for the world to believe that the worst is going to happen, and at

various stages in its depreciation it has foreign support as well as domestic support.

Thus we saw the unanchored paper pound, 1931-1939, treated by British policy as "a thing-in-itself" and no longer a promise to pay gold, still accepted, though with growing distrust, by central banks of the Scandinavian and Baltic countries as a substitute in part for their own gold reserves. The financial prestige of Britain was very great. Value is a psychological phenomenon. But there are rational elements in the psychology of value, and hope too long deferred and too often disappointed will destroy value.

GOVERNMENTAL COERCION AND THE VALUE OF MONEY

YET ANOTHER FACTOR can be invoked by governments to sustain the value of irredeemable paper money, and that is the power of the government over the economic lives of men. In the period of the French Assignats, the laws fixed penalties of the severest kind against transactions which recognized the depreciation of the paper. But despite the penalties, the French paper money dropped steadily in value and commodity prices soared. The Federal Congress in 1864, blaming the depreciation of the Greenback on the manipulation of speculators in the gold market, passed an act forbidding gold futures. The results were disastrous and the Congress, without debate, repealed the law two weeks later.

It was prevailing doctrine among economists down to the First World War that governments could not coerce their peoples into accepting at face value a dishonored paper money. But war brought an immense revival and intensification of governmental power, and new governmental techniques for intruding intimately into the bookkeeping of the people. In Germany this power was intensified under the Hitler regime and these techniques were elaborated, and we have had the spectacle in Hitler's Germany of a paper currency, with a microscopic gold reserve and without gold redemption, circulating against commodities at fixed prices for the commodities or, at all events, at controlled prices. As faith waned, Germany substituted coercion, and as the government was virtually omnipotent, and the people dared not assert their individual rights, and as the Gestapo was tremendously efficient, Germany made the system work.

COERCION AND FOREIGN EXCHANGE RATES

ALWAYS THE DOCTRINE HAD BEEN, moreover, that even though a dishonored paper currency might be accepted at home, nothing could prevent

it from depreciating in the foreign exchanges, because the people would smuggle it out of the country and sell it for what it would bring to get good money. But we saw develop in Germany a system of control of the export and import of currency, as well as securities and commodities, so tremendously effective that very little German currency could get outside and that when it got outside, the foreign banks had little motive for buying it because they could not get it back into Germany again to use it. We saw rigorous control of all exchange transactions, and such a limitation in the volume of these transactions that the German government and the Reichsbank could make the so-called "official rate" effective on the limited volume of transactions permitted, and the "official mark" in the foreign exchanges held firm at the nominal parity. Meanwhile a great multitude of different kinds of marks, valid for special purposes, sold at varying rates of discount in the foreign exchange markets, but even these were regulated and controlled.

THE TYRANNY OF HITLER AND THE TYRANNY OF GOLD

THE TEMPORARY SUCCESS of the German monetary and economic experiment led to the superficial generalization on the part of certain opponents of the gold standard that gold had been proved to be unnecessary, that Hitler had found a way to do without gold, and that the long tyranny of gold was over. Parenthetically, I much prefer the tyranny of gold to the tyranny of Hitler. Gold is not capricious.

All it requires of men and governments and central banks is that they be honest, that they keep their promises, that they keep their demand liabilities safely within the limit of their quick assets, and that they create debts only when they can see how these debts can be paid. Gold has no intuitions, and gold has very little imagination.

In summary on this point: (1) Men, governments and central banks will accept gold in payments because they want it for itself. (2) Men will take paper promises to pay gold as money without difficulty so long as these promises are kept and they believe that they will be kept. (3) When paper promises to pay gold are dishonored men will continue to take them at varying degrees of discount in the hope that the promise will later be kept, and because of the prestige of the issuing authorities, fortified by the legal tender peculiarities of money and by the habits of the people and of the world with respect to a long established currency. And finally, (4) when these fail, if your government is powerful enough and tyrannous enough, and your people are sufficiently submissive, and you extend the government into the

details of the daily transactions of the people, you can make a dishonored paper circulate at controlled prices inside your country, and you can keep it out of the foreign exchange market. If foreigners happen to have deposits in your banks which they want to sell in the world's markets outside, you simply refuse to allow them to transfer these balances on the books of the bank, or you limit the uses to which they can put them in your own discretion.

THE LIMITS OF COERCION

THE POST-WAR WORLD will witness, I have no doubt, the complete collapse of the Hitlerian monetary system. I venture the confident prediction that the forces of coercion which have been sustaining the value of the German mark will soon be sensibly abated, and that the controls which have upheld the mark in the foreign exchanges will work with diminished effectiveness.

And the British experiment of a pound unanchored to gold, treated as a "thing-in-itself," can give us a very tragic picture. The prestige of that pound in the international markets is badly shattered. Foreigners who had entrusted their funds to London found them promptly blocked when the war came. The pound has ceased to be a serviceable tool in trade between Britain and other countries, and has almost entirely ceased to be a tool for conducting trade between two outside countries—which used to be one of its most important services. It has in general ceased to be a valid tool for trade among the units of the British Empire. In general it prevails only in the mother country itself. England has gigantic blocked debts to the outside world due on demand, but she does not allow her creditors even to sell their credit claims for what they can get.

But men and governments are still eager enough for gold. Gold is being currently used on British Government account to pull down the great discount on the rupee in India and to bring out hoarded food reserves in India. Gold is being used in Persia which is glad to get gold but reluctant to take sterling.

GOLD AS THE POST-WAR INTERNATIONAL CURRENCY

Now what is the outlook for an international currency in the postwar world? Men, governments and central banks all over the world will take gold without question whenever they can get it. Most of the paper currencies of the world they will not take except at heavy discount and in limited amounts, and they will seek to hedge them if they can, and they will seek to pass them on quickly if they can when they take them. The American dollar

they will readily take because of our practice of exporting gold when the dollar goes to the "lower gold point" in the foreign exchange markets. What else is there but gold to serve as an international currency? I think there is nothing else.

THE KEYNES AND WHITE PLANS REST ON COERCION

BUT THIS IS NOT THE VIEW of the British Treasury represented by Lord Keynes, nor the United States Treasury represented by Mr. Morgenthau and Mr. White. Lord Keynes proposes an international currency not redeemable in gold, not based on gold, nominally fixed in relation to gold "but not unalterably." He calls it "bancor," apparently a compound of the two words "banco" and the French word for gold, "or." But it is not even gilded, much less gold. The international money is to be credit entries on the books of the international fund and overdraft privileges with that international fund. The assets of the fund are zero when the fund starts and its liabilities are zero, but as transactions multiply and the fund does business, its balance sheet swells on both sides, its liabilities being deposits in bancor and its assets consisting either of overdrafts in bancor or of a multitude of national currencies-dollars, pounds, francs, drachmae-and in time, presumably, German marks. Its purpose is to hold the different exchange rates together, to put the strength of the stronger exchanges behind the weaker ones. It would increasingly lose dollars and other strong currencies and increasingly acquire weak currencies or the bancor obligations of the central banks or exchange stabilization funds of the weaker countries. Its assets would progressively deteriorate. Indeed both Keynes and White plans contemplate this. They contemplate reductions in the exchange rates of the weaker countries, and in the nominal gold equivalent of the bancor or unitas.

Now, on what substance can the value of bancor rest? On gold? No. The Keynes plan has some ingenious devices to prevent situations in which bancor could be shown to be at a discount in terms of gold, which, however, could break down readily, even with good faith on the part of all the participants in the fund, which would certainly break down if important countries remained outside the fund, and which would break down in the event of any failure of any country to comply with the requirements of the fund. But it does not rest on gold. The bancor is explicitly never to be redeemed in gold nor in anything else. On what, then, will it rest? On faith? On prestige? Maybe we can create a prestige for an international fund whose assets consist of the dishonored promises of governments and central banks which have

lost their prestige. It is possible that the prestige of the United States would be so great that for a time we alone could carry the burden of sustaining the bancor, but I doubt that our generosity is sufficient for this, and I question that we dare risk our strength, already strained by our war finance, in so great and so needless a post-war task.

But neither the Keynes plan nor the Morgenthau plan proposes to rely upon faith alone. Both propose a great deal of coercion. Governments are to coerce their peoples in preventing the international movement of capital funds, which means, as Keynes himself recognizes, the control of all foreign exchange transactions. Now here, I think, we find real difficulty. Who shall coerce the coercers?

Who shall force the government of the United States, or the government of Russia, or the government of Britain, or the government of Argentina to comply with the mandates of the governing board of the international fund? The provisions of the White-Morgenthau plan make it very explicitly their duty to do so, and section VII, 8, of the July 10 version of the White plan makes it the obligation of every member country of the fund "to adopt appropriate legislation or decrees to carry out its undertakings to the fund," and those undertakings are numerous and drastic. For either the Keynes plan or the Morgenthau-White plan to work, would require a world state with an authority over economic transactions as great as the authority which any national state has effectively asserted in peace time.

Is it realism to suppose that the whole world can hang together in the support of bancor or unitas when the British Empire can't hang together in support of sterling within the British Empire?

The Keynes plan, moreover, definitely suggests international control of commodities and an international "over-normal granary," and an international control of investment. It sees the Clearing Union as facilitating these purposes as well as foreign exchange stabilization. The document states, "We have here a genuine organ of truly international government." The White plan is not so frank, but there is much sympathy for these ideas in important Washington circles.

WAS THE OLD GOLD STANDARD A "STERLING STANDARD"?

THERE IS A MYTH widely current which I wish to challenge. It is that prior to 1914, the world was on the sterling standard rather than the gold standard, that London controlled the gold standard and that it was only

super-human wisdom in London which made it work. The doctrine adds that when New York became the center after 1918, the gold standard failed because New York lacked London's wisdom. Now the fact is that pre-war London had far less control and responsibility prior to 1914 than New York did after 1918, and that policy played a much smaller role in the earlier period. There were many gold standard money markets competing with London for gold prior to 1914, several of them very powerful, as New York, Berlin, and Paris, and many others of real influence, as Amsterdam, Vienna, Switzerland, the Scandinavian countries, and Japan. These all steadied one another. All would pull gold away from any country that was over-expanding credit, and force it to pull up. It was not policy. As Mr. Woodward of the Central Hanover said to me one time, "It was nature." International cooperation came only in crises-and then at stiff rates of interest. Now New York lacked this steadying influence from 1918 down to 1925, and did not get adequate competition for gold till France got into the game-in an overdrastic way-in 1928. New York used policy in the 1920's-bad policy. But I must add that Benjamin Strong learned this bad policy from Montagu Norman. Both we and London over-expanded credit in the 1920's, but we had the semblance of an excuse in our over abundant gold, while London had no excuse at all.

I want to see a real gold standard world again, with several powerful money-centers competing for gold, and holding one another in check. I don't want international monetary cooperation in ordinary times. It prolongs unsound tendencies, as in 1924-29, and then it breaks down in crises, as in 1931. I want competition in ordinary times, and cooperation only in crises—at a stiff rate of interest.

I have been too close to the centers of wisdom and power in governments and central banks to have any belief at all in the adequacy of their wisdom to do more than routine things. The more I see of governmental economic policy, the more I trust the automatic forces of free markets. The more I see of public monetary policy, the more I trust gold.

Dr. Anderson has dealt with this subject twice previously: (1) An address before the Los Angeles Chamber of Commerce on May 11, 1943; (2) An article in The Commercial and Financial Chronicle of Dec. 16, 1943. Reprints of these may be obtained from the Economists' National Committee on Monetary Policy, 70 Fifth Ave., New York 11, N.Y.

INTERNATIONAL FINANCIAL ORGANIZATION



Address by J. H. Riddle, Economic Adviser, Bankers Trust Company, New York, before the Academy of Political Science, April 12, 1944

In the debate over stabilization plans and foreign credits we sometimes lose sight of more basic factors. There are two fundamental pre-requisites to stabilized exchanges which should be kept in mind in any discussion of plans. One is international peace and political stability, and the other is internal political and economic order.

International political conditions constituted one of the principal reasons for the failure to achieve permanent exchange stability in the interwar period. Political fears and uncertainties not only hamper the free flow of funds in the usual channels, but stimulate flights of capital and throw international payments seriously out of balance. The restoration of genuine peace and security throughout the world will do more to promote long-run exchange stability than any other single factor.

The establishment of internal political and economic order is almost equally important. Unstable governments, unbalanced budgets, and general internal economic disorder are not conducive to balanced international accounts and stable exchange rates.

International financial organization in the transition period must be adapted to the conditions and problems that will prevail at that time. A world torn by five or six long years of destructive war cannot return to a state of balanced order overnight. Political strife and economic chaos will prevail in many areas; some countries may be without responsible governments, for a time at least, and world trade relations will be completely disorganized. There will be only a few creditor countries at most, and many debtor countries with the current balance of payments running strongly and consistently against them.

Stabilization Procedure

In the world of disorder that will prevail, I can think of no more practical approach to the short-term problem of stabilization than to deal with each currency separately, beginning with the pound sterling and other key currencies. This is sometimes known as the "key-country" approach.

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The major problem will be for the great nations to put their own houses in order. If they can keep the peace of the world, bring their own international accounts into better balance, and are willing to eschew policies that depress other currencies, the major battle for world stability will have been won.

On the other hand, if the great nations do not meet these requirements long-run stability cannot be achieved. It was largely the actions and policies of the four great powers between the two world wars that prevented a reasonable degree of exchange stabilization and economic order in the world.

Stabilization Agreement with England

The first task, if we wish to do something practical and concrete, is to work out plans with England for stabilizing the dollar-pound rate. That agreement could include provision for consultation regarding a change in rate if and when basic conditions seem to warrant, thereby protecting the pound against the effects of too great rigidity. Arranging a stabilization agreement with England faces two difficulties; one arises from differences in stabilization theories between, countries, and the other from England's debit balance.

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The English seem reluctant to tie the pound too closely to the dollar or to gold. They want some stability, but not too much stability. They are keenly conscious of unemployment problems and other domestic social issues, and the question seems to be whether some variability in the exchange rate may not be necessary to maintain stability in the internal economy. To what extent this policy can be reconciled with the goal of international stabiliza-

tion remains to be seen. I should add, however, that Keynes himself recognizes



far more clearly than he did a decade ago, the destructive effects of freely flexible exchanges and the necessity for substantial stability.

The second difficulty arises partly from the large blocked sterling balances accumulating, and partly from a debit balance of payments expected to prevail after the war. England has probably lost half her income from foreign investments and much of her foreign income from banking and shipping.

Most of the blocked sterling balances, however, are due to Empire countries and perhaps settlements can be reached directly with the countries concerned. England still has substantial investments in some of the countries that have built up sterling balances. Some of the blocked balances could probably be refunded into long-term securities, and some settled by the shipment of manufactured goods from England.

There is some doubt as to whether her post-war international accounts will be as much out of balance as some of the more pessimistic calculations indicate. She may produce more food than formerly. Production costs have been held down much more effectively in England than in the United States, which should help in the redevelopment of her export trade. England's productive equipment is still in far better shape than that of other European countries, and the fact that many countries have built up balances in London will serve to give her an outlet for goods.

No doubt England will have to maintain certain exchange and trade controls until blocked balances are reduced to more manageable proportions, and her international accounts brought more nearly into balance.

It has been suggested that some of England's initial needs in the post-war period might be supplied by lend-lease. This suggestion raises difficult questions, but it might be explored, if coupled with a proviso for more definite but liberal terms of repayment. It is within the defense interests of the United States to see that England starts on the road to possible of the United States which the war has imposed upon her.

Whether England will need stabilization credits, and how to meet these needs in a manner mutually beneficial to both parties, is a matter for careful study. As her credit position improves, she could probably float a substantial public loan in this country. To give England more time to work out her problems, we should postpone for five years the settlement of lend-lease aid, and cancel her World War I debt obligations to us.

Other Currencies

In emphasizing the need for stabilizing key currencies there is no thought of excluding other currencies from the arrangements, or of neglecting them. Any country would be included in the agreements when it can take the necessary steps to stabilize. The problem of each country is different, and the nature of the adjustments to be made will vary widely. Some countries will have little difficulty in fixing and maintaining rates in terms of dollars.

Others, such as the occupied countries, will face greater difficulties. Some will suffer from internal political dissension, as well as chaotic fiscal and economic conditions. In those countries exchange controls will have to be maintained longer while they work out their problems. The task rests largely with the individual countries. No one else can do that job for them. Each country must put its internal house in order and show the necessary determination to bring its international accounts into some kind of balance. Credits should be granted only on the merits of each individual case.

Responsibility of the United States

A major responsibility rests upon the United States to take the lead in stabilization. The dollar should be the strong currency around which general stabilization efforts center. That would require the United States to put its own fiscal affairs in order, and to keep the dollar firmly fixed to gold at \$35 per ounce, with unrestricted exports and imports of gold.

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The United States should also assume the true role of a creditor country, and give greater encouragement to the importation of foreign goods. A nation is enriched by its imports rather than by its exports. We export in order that we may import. A reduction of tariff barriers would facilitate the development of multilateral trade and the solution of exchange problems. If we accept more foreign goods, other countries will have more dollars with which to buy our goods. A greater willingness to accept British goods would facilitate the working out of a stabilization agreement with England.

International Bank

Some kind of international institution is desirable as an aid to stabilization efforts, but it should not have broad powers of control over international trade and the economic affairs of nations. It might be an international bank with a simple structure and limited powers, acting largely as the instrumentality of the principal central banks and treasuries.

I have in mind an institution similar to the Bank for International Settlements, which, if freed completely from reparation payments and German influence, and with certain other charter changes, could be adapted to the new problems. If the prejudice which has grown up against that institution would prove to be a handicap, however, a new organization along similar lines, with necessary modifications, could be established. (1)

Such an international bank would be a meeting place for central bankers and treasury officials to discuss monetary problems. A central place for officials to meet and exchange ideas would promote among them a better understanding of each other's problems and encourage maximum cooperation in monetary matters. Principal reliance for the success of the institution would be based on friendly official and personal re-

⁽¹⁾ The institution suggested here should not be confused with the United Nations Bank for Reconstruction and Development proposed by Treasury experts for encouraging or providing long-term loans.

lationships, information and persuasion. Free collaboration by the nations, rather than compulsion, would be the basis of operations.

One function of the bank would be to collect international statistics and other information. It would maintain a corps of experts and make comprehensive studies of the exchange problems of various countries. It would become a consultative body on international monetary matters, including proposals for changing rates to meet basic conditions. Its expert knowledge and advice could help guard against too great rigidity of rates as well as against hasty and ill-considered changes that might lead to retaliatory measures.

The bank could handle international clearings, including gold clearings, thereby facilitating international transactions and minimizing gold shipments. It would have only limited lending functions; the major credits would have to come from the creditor countries. However, countries could grant mutual aid through its facilities. The bank could aid in the negotiation of stabilization credits which might be extended by the creditor countries, and could aid in the servicing of international loans.

The international bank would extend limited credits to cover seasonal or other purely temporary needs, thereby enabling countries to avoid exchange difficulties or rate changes because of a temporary lack of balance in their international payments. In this way it would facilitate the operations of existing banking machinery for financing international trade and for making current international payments. In no sense should it be an eleemosynary institution. It would not grant long-term loans, or make loans to cover the chronic lack of balance in a country's payments.

The International Bank would not require a big capital fund, probably not over \$500 million. Central banks and governments would supply the capital, but subscriptions from all countries would not be essential. A few founding countries could subscribe for the majority of the shares and

organize the institution.

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Keynes and White Plans

The Keynes and White plans for stabilization have been under discussion about a year. Many changes have been made in them and the discussions are continuing with a view to arriving at some agreement between the experts of the two countries. What the status of these plans is today or what the ultimate compromise may be, we do not know. If finally reduced to some simple, practical organization, it may find acceptance.

In their original forms, however, those plans were entirely too ambitious and quite impractical. They relied rather heavily upon generous credits to solve the world's difficulties. They provided for credits based on quotas or formulas that had little relation to credit needs or credit worthiness. They seemed wholly unsuited to the conditions that will prevail in the transition period. If a stabilization fund of the kind suggested should be established now, it would inevitably be utilized to finance some of the chronic debit balances of the transition period, and might be left in such a frozen condition as to interfere materially with its usefulness later on. The original plans provided for broad controls over international transactions and seemed ontirely too complex to be generally acceptable.

New Mechanisms and Generous Credits

In spite of past experiences the belief still seems to exist in some quarters that the world's economic problems can be solved by elaborate new mechanisms and generous credits. There is no magic in mechanisms, however, and there are a great many problems that credits cannot cure.

After the last war, there was a great demand for new facilities to finance foreign trade. A number of organizations were established for that purpose, both in this country and in England. The imposing list of names includes: The Mercantile Bank of the Americas, Inc., The American Foreign Banking Corporation, the Asia Banking Corporation, The Park-Union Foreign

Banking Corporation, The Foreign Credit Corporation, the Federal International Banking Corporation, and the First Federal Foreign Banking Corporation. The British list is almost as imposing. Mr. Wilbert Ward, Vice President of the National City Bank of New York, in a recent survey of these institutions and their activities said that, "On both sides of the Atlantic they dissipated their capital, and made no important contribution toward achieving the objectives outlined in their prospectuses." (1) In the course of a few years they had run into difficulties; some disappeared and others were absorbed by older institutions. Much of the capital funds put into those institutions was lost.

Substantial amounts of long-term loans were also extended to European countries in that period. Of the loans made by the United States Government to foreign governments in connection with World War I, about \$3 billion were advanced after the Armistice. A large portion of them went to Continental Europe, either directly or through England. There were also substantial private loans made to Europe during the 1920's, perhaps as much as \$2 or \$3 billion. These loans and the agencies for financing foreign trade, however, did not result in any lasting stabilization of European currencies. On the contrary, they increased long-run exchange difficulties, as a rule, because they piled up additional debts and lulled borrowing countries into doing nothing about needed readjustments in their affairs. The fact is that we were generous with credits during that period, but generous credits do not solve stabilization problems.

The purpose of stabilization efforts should be to make the participating countries self-reliant. Loans and credits granted to a debtor country should enhance its productivity and increase its power to meet foreign obligations. Foreign credits granted for non-productive purposes, with no clear prospect of creating additional exchange resources, will accentuate

⁽¹⁾ Wilbert Ward, "Foreign Trade - Post-War Plans and Frospects," a reprint from Burroughs Clearing House, January, 1944.

exchange difficulties rather than relieve them, as we saw in the inter-war period.

To grant credits to a country simply because it has an unfavorable balance of payments would be somewhat like making loans to a corporation because it operates in the "red." Either condition may indicate the need for reorganization and new policies. The London Statist has said: "There is no method better calculated to perpetuate disequilibrium than the distribution of largesse on an international scale to all countries whose balances of payments happen to be in debit. There is far too marked a tendency among academic commentators on the currency schemes and on the world capital bank plan to regard the existence of a deficit in a country's balance of payments as sufficient reason for granting it help in the shape of short- and long-term credit." (1)

America will aid in the relief and rehabilitation of many of the war-torn countries, but we should make a sharp distinction between relief and credits. Let us not grant relief in the form of credits that cannot be repaid, thereby piling up international obligations that will bedevil the exchanges and our international relations for decades to come. A United Nations relief organization has already been established to which the United States has and will continue to contribute generously. Perhaps other aid could be granted through lend-lease. Our Government will possess large stocks of equipment, machinery and other materials for which there may not be much demand in this country, but which might be lend-leased on liberal terms of repayment.

Foreign Buying Power in This Market

It is incorrect to assume that foreign countries are without reserves of buying power that can be utilized in this market. It is estimated that

⁽¹⁾ The Statist, International Banking Section, November 27, 1943, p. 4. Digitized for FRASER

foreign countries own approximately \$13 billion of gold, and foreign banking funds held in the United States aggregate about \$5 billion. (1) That makes a total of \$18 billion of gold and dollar exchange held by foreign countries, not including foreign investments here probably aggregating \$5 or \$6 billion. The world's production of gold outside the United States will probably rise rather quickly to over \$1 billion per year after the war.

The principal source of dollars for foreigners, however, will be our imports, visible and invisible. The greatest single contribution that the United States can make to the recovery of the world and to stabilization efforts will be to maintain prosperity in this country. The volume of our imports varies directly with our business activity. A high level of activity requires a high level of imports. The Bureau of Foreign and Domestic Commerce has estimated, on the basis of certain assumptions as to gross national product, that our merchandise imports might aggregate over \$6 billion by 1948, and invisible imports, plus long-term capital transactions, another \$4 billion.

How the United States can maintain a high level of business activity is not within the scope of this paper. Free private enterprise can perform this service for the country and the world, however, if the investment incentive is not too severely repressed.

There seems little doubt as to the ability of our present banking system, with its foreign branches and connections and years of experience, to finance any amount of foreign trade that may develop, and grant terms to foreign importers of raw materials that will cover the time necessary to process the goods and export the finished products.

Long-Term Loans

There will probably be substantial foreign demand after the war for American capital for reconstruction and developmental purposes. If an era of

genuine world peace can be restored, no doubt in time a natural flow of private capital to foreign countries will develop. For the time being, however, there may not be much enthusiasm on the part of private investors for foreign securities. Temporarily, some governmental agency may have to be the spearhead for long-term foreign loans. Since the United States will be practically the only important creditor, with many debtors, the suggestion that the loans be made by some institution with an international board of directors seems unacceptable.

I suggest that we explore the possibilities of expanding the powers and functions of the Export-Import Bank with a view to making it the center of our foreign long-term loan activities in the transition period. The organization is already set up and has had years of experience in dealing with foreign countries. Apparently its commitments have been made with care and the Bank has been able to avoid some of the pitfalls of private investment during the 1920's. As in the past, the funds used might be supplied chiefly by private sources under the guarantee of the Export-Import Bank.

It would be a healthy development if the flow of long-term productive capital to foreign countries could take the form of direct investments, or the purchase of equities, rather than of loans. It would allow greater latitude of time in making transfers and reduce the burden on international exchanges, because returns would not run counter to the exchange position of the capital-importing country. On the whole this type of investment seems to weather economic storms better than fixed-interest investments. One suggestion that may be worth pursuing is that with suitable government attitudes our industries might participate directly in helping to reconstruct European industries.

Limitation on Commitments

The extent of our credits, loans, and investments abroad will presumably depend largely upon the kind of world that will develop, and the extent of inter-governmental guarantees against confiscation. The international political outlook is by no means clear. Different political ideologies will prevail in different parts of the world, and we do not yet know what spheres of influence may develop or what kind of international organization may be set up. The outlook for the development of foreign trade is equally obscure. Different kinds of economic philosophy and trading practices will prevail among the nations; government monopoly of foreign trade in some cases, cartols, division of markets and preferential arrangements in others. How will this affect the course of our efforts at free competitive enterprise?

These uncertainties would seem to suggest caution against large-scale global credit commitments. It may be wise to limit the scope of our future commitments and to concentrate on those areas and countries which are more directly associated with our interests, at least until we see what the new world order will be.

Summary of Conclusions

- (1) ** major contribution which this country can make to stabilization efforts would be to maintain prosperity at home, thereby encouraging imports and supplying dollars with which foreigners can buy more of our goods.
- (2) The United States should put its own finances in shape and make the dollar the strong currency around which stabilization efforts center. The dollar should remain firmly tied to gold at \$35 per ounce, and both exports and imports of gold should be unrestricted.
- (3) Each country must restore internal order and put its own finances in shape before its currency can be stabilized. These measures cannot be im-

- (4) Exchange stabilization must be worked out country by country, and credits must be considered on the merits of each case. The chief problem is for the major countries to keep their own currencies stable, and to follow policies favorable to international stabilization.
- (5) In so far as possible, reliance should be placed upon existing financial agencies, with necessary adjustments, instead of establishing elaborate new international financial mechanisms.
- (6) An international bank with a simple organization and limited powers seems desirable to facilitate international settlements, to direct international financial studies, to serve as a meeting place for central bankers and monetary authorities, to act in a consultative capacity regarding stabilization problems, and to grant limited short-term credits.
- (7) Long-term reconstruction and developmental loans can be made by an onlarged Export-Import Bank, or private funds can be advanced with the guarantee of the Export-Import Bank.
- (8) There should be a sharp distinction between gifts and credits.

 Credits that cannot be repaid create exchange difficulties in the long run.
- (9) Direct investments abroad should be encouraged by suitable governmental policies and guarantees against confiscation. Where long-term loans are essential they should be limited to productive purposes which are calculated to produce foreign exchange sufficient to service such loans.
- (10) Until we know more about the political complexion of the world and the various spheres of influence that may develop we should avoid global credit arrangements and restrict our commitments to particular areas and countries.
- (11) Lasting international peace and political stability are prerequisites to permanent stability of currencies. Without these no stabilization measures or plans will succeed in the long run.

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April 29, 1944.

Mr. Leon Fraser, 2 Wall Street, New York, N. Y.

Dear Mr. Fraser:

I appreciate your exceedingly kind letter of April 28th.

I set out a short time ago to examine the thesis which I have long held, that dollar bonds scattered throughout the non-gold holding nations of the world, are not an economically sound investment for the people of the United States.

It is clear that when Great Britain assisted us in building our railroads in the latter half of the Nineteenth Century, she accepted bonds
stated in our currency and did not require sterling bonds stated in
her currency. The only exceptions were a few issues which permitted
alternative payment in sterling at a paying agency in London. They
were not substantial. If they had been, the United States probably
would have defaulted on these sterling obligations just as the rest
of the world is now defaulting on our dollar obligations.

To round out my proposal, it was necessary to set up the type of controls that would enable the people of the United States to make investments abroad, other than in dollar obligations.

I have accordingly developed a treatise on this subject, of which I am pleased to enclose a copy.

The result is an exposition of what might be called "The American Way of Life"; or applied democracy. It expresses the thought that this method of government could be extended by the peace treaty to many countries which will be liberated by the force of American arms, much as we gave that type of government to the Philippine Islands.

Stabilization of currencies after the war is an accepted principle which no doubt will be put into effect. It will not solve the problem of long-term credits, but it should stabilize foreign currencies to a considerable extent.

I appreciate what you say of the manner in which the British Government has protected the interests of their investors abroad.

I am starting with the proposition that what the American people most desire is a world condition of democratic autonomy. That is what we affirmatively established in the Philippines. But it never would have been so established had we left the selection of the governmental mechanism to the immature and downtrodden Filipinos themselves.

In the same way, if the peace conference as a part of its legal function will set up a similar mechanism in such countries as Korea, possibly Siam, and others that we will be instrumental in liberating, and if the status so established is guaranteed by the four participating great powers, that is, United States, Great Britain, Russia and China, then when this operating condition is established, we will have a general status of world law and order somewhat along the line that you indicate Great Britain has established in its dominions and colonies.

Assuming some measure of progress in the establishing of such a status, the thesis which I have attempted to state in the enclosed manuscript is that the United States should then turn from the imposition of dollar obligations on all foreign countries as the basis of its overseas investments, to investments originated by the reinvestment of the proceeds of a favorable balance of trade, in the countries giving us such favorable balance.

The proposition is subject to mathematical demonstration that if the world at large has little or no dollar exchange or gold, it will be impossible for the world at large to give us a favorable balance of trade paid for in dollars.

Nevertheless, we need a favorable balance of trade to operate our extended industries. So what? It seems obvious that we must accept our pay for at least part of this favorable balance that the United States needs, in the only medium that our prospective purchasers have. That is, their own currencies. It will then be up to us to safeguard these receipts and carry on from that point.

It should be done by the reinvestment of those currencies representing our favorable balance of trade, in enterprises established in the several countries, largely Amerigan managed and owned. These investments should include an international banking system, in order to give the people of the United States financial supervision of their investments in foreign countries, just as the United States is entitled to a world-wide communications system, which will be under the supervision and management of its own nationals.

While I, of course, realize that the war debts of World War I, as a practical matter, have necessarily been charged off as a loss by the American people, nevertheless had an effort been made to collect those debts in foreign

currencies (which at least would have been better than total default), not only would a breakdown in international credit have been prevented, but the comment contained in the first paragraph of your letter, that the emphasis should be put "on increasing our imports, increasing our tourists and endeavoring to lessen the gap between the total export balance and the total import balance", would have been put into effect.

I have attempted to state the same thought at pages 54 and 55 of the enclosed manuscript, as follows:

"Also, if these bonds (foreign currency bonds executed by our international debtors) then had been distributed to the American taxpayer with the reasonable requirement that interest be paid in dollars which would not have been burdensome, and further provision made for payment of a moderate sinking fund in currency of the debtor nation, these bonds would have constituted the basis of the most extensive revival of foreign travel by intelligent but financially inept Americans, that has ever been known. Instead of the doldrums of the thirties, foreign trade and travel throughout the world would have been revived and Americans who have never studied foreign exchange through the medium of foreign travel, would have become as familiar with the attractions of Athens, Prague, Helsinki, London and Paris, as prior to the depression of the thirties, they were with Niagara Falls, Palm Beach and the Rocky Mountains."

I appreciate, of course, that your experience, including your term of office with the Bank for International Settlements, has been greater than perhaps any other individual in the United States, on the subject of foreign exchange and foreign credits.

At your convenience, I would extremely appreciate your kind review of the enclosed thesis. You will observe that The New York Times has released to me for publication in book form as a part of this volume, two important articles, one entitled "Self-Determination held to Involve Responsibilities", by Ralph Barton Perry, Professor of Philosophy at Harvard University; the other, "Republic in Japan is Urged by China", by Dr. Sun Fo, President of the Legislative Yuan of the Chinese Government, and son of Dr. Sun Yat-sen, founder of the Republic of China.

The result is a homogeneous presentation of the fact that what the world needs is that the status which should be established by the peace treaty is autonomous democracy, rather than in all cases pure self-determination, which quite naturally might restore the Nazi and Fascist governments to Germany and Italy.

In a stabilized order of autonomous democracy such as the United States established in the Philippines, there would be a tremendous opportunity for world trade, which in turn would give the United States the export surplus which it requires to operate its industries and employ its workers in gainful industry after the war.

I would very greatly appreciate your comments on this manuscript.

rville C. Sanborn

THE NEW WORLD

An American Peace Plan

by

ORVILLE C. SANBORN

with

Introductory Chapters

Self-Determination Held to Involve Responsibilities

by

RALPH BARTON PERRY

Professor of Philosophy at Harvard University; Former President of American Philosophical Association; Chairman American Defense Harvard Group, and author of "The Approach to Philosophy" (1905); "The Free Man and the Soldier" (1916); "The Present Conflict of Ideals", and many other books.

Republic in Japan is Urged by China

by

DR. SUN FO

President of the Legislative Yuan of the Chinese National Government, and son of Dr. Sun Yat-sen, Founder of the Republic of China.

COMPROMISE PLAN FOR INTERNATIONAL CURRENCY STABILIZATION

A compromise plan for international currency stabilization was announced on April 21, 1944 in the form of a joint statement of principles by the monetary experts of United and Associated Nations. The new plan is a considerable improvement over the original proposals. It is quite similar in general outline to the revised White plan, although many details have been omitted and a number of changes have been made.

The new plan provides for the establishment of an International Monetary Fund of about \$8 billion if all United and Associated Nations subscribe, and about \$10 billion if all the nations of the world subscribe.

The White plan provided for a fund of \$5 billion. While the quotas of member countries have been increased, the gold contributions required have been reduced. The revised plan provides that gold subscriptions of a member country shall be fixed at 25 per cent of its quota, or 10 per cent of its holdings of gold and gold-convertible exchange, whichever is smaller. The quota of the United States would be between \$2,500 million and \$2,750 million, of which about \$650 million would be contributed in the form of gold.

Without attempting to make a detailed analysis of the various provisions in the compromise plan, the following will indicate some of the important changes as compared with the revised White plan:

- (1) The suggestion for a new international monetary unit is omitted and each currency would be related directly to gold.
- (2) More discretion is given to the Fund in the granting of credits, but the formula based on quotas is still there for the guidance of the management.
- (3) Less emphasis is placed on controls over the economic policies and activities of member nations.

- (4) More liberal provision is made for changing parity rates when basic economic conditions warrant. (For example, the Fund would not reject a proposed change in rates because of domestic social or political policies of a country requesting the change.) This may be advisable, but it could be subject to abuse.
- (5) It is specifically stated that the Fund is not intended to provide facilities for relief or reconstruction or to deal with international indebtedness arising out of the war. It is essentially a long-run proposal and suggests that debit balances in the transition period should be met in a manner that will not unduly encumber member countries' facilities with the Fund.
- (6) During the transition period wartime exchange controls may be adapted to changing conditions and less emphasis is placed on the early removal of such controls.
 - (7) A member country may withdraw at any time on written notice.
- (8) Provision is made for an executive committee of nine, including representatives from the five countries with the largest quotas. Presumably, the five countries with the largest quotas would be the following: the United States, Great Britain, Russia, China, France. This is apparently intended to indicate that the management will be largely in the hands of the major countries.

It is possible that some of these differences may be more apparent than real. The new plan is only a statement of principles and is, therefore, in abbreviated form. When the details are supplied, it is possible that some of the provisions might seem more nearly like earlier proposals.

In the matter of capital movements the present draft is even more obscure than previous plans as to the degree of control that may be necessary or the manner

in which it will be exercised. The new plan is silent as to steps that should be taken by debtor countries or creditor countries to restore a greater degree of equilibrium in their international transactions. Perhaps when the details are supplied they may be similar to those in the White plan.

Appraisal of Compromise Plan

In spite of the improvements made, some of the basic objections to previous drafts of the stabilization plans still hold. The compromise plan still seems to place too great reliance on credits as a solution to exchange problems, and does not seem to emphasize sufficiently the necessity for each country to put its own house in order through sound fiscal, currency and credit policies. To set up a large international fund for granting credits as the means for promoting exchange stability and maintaining orderly exchange arrangements places the emphasis in the wrong place. It would encourage member countries to believe that the existence of the Fund will solve their exchange problems regardless of internal policies.

The system of credits based on the quotas of member countries seems rather unrealistic and impractical as a basis for operations. The quota of a member country may have little relation to its actual credit needs or to its credit-worthiness. The power of a member country to purchase foreign currencies is limited to 25 per cent of its quota in any one year, and there is an over-all limit of 100 per cent of its quota plus an amount equal to its gold contribution. Thus, if this formula is adhered to, a country could berrow a little each year and exhaust its facilities in four or five years.

⁽¹⁾ The Fund's heldings of a member country's currency cannot normally exceed 200 per cent of that country's quota. If, therefore, a country originally subscribed 75 per cent of its quota in currency and 25 per cent in gold, it may purchase foreign currencies equal to 125 per cent of its quota. Since the gold contribution equals 25 per cent of the quota, however, the maximum actual aid granted by the Fund is only 100 per cent of the quota.

By establishing such a formula each country is encouraged to believe that it has a right to credits up to the stipulated amount, and no doubt most of them will make every effort to get their share regardless of internal conditions and the general state of their international accounts.

The management of the Fund is given the power, in its discretion and on terms which safeguard the Fund's interests, to waive any of the conditions imposed on purchases of currencies. The effectiveness of the Fund, therefore, would depend in a measure on how it is administered. With such a large Fund available, however, and with the specific credit formula for the guidance of the directors, it is difficult to see how the dissipation of substantial amounts of credit could be avoided. The Fund could be the source of serious political squabbles and misunderstandings.

As set up the plan still contains a large element of the basic Keynesian idea of expanding world trade through credits. The thought seems to be that facilities for so-called impersonal credits of this kind would encourage member countries to take greater risks and, therefore, lead to a larger volume of world trade. The idea of expansion seems to be more prominent than the idea of stabilization. A question might be raised as to the compatability of the two ideas. Credits for purposes of expansion may turn out to be long-term credits, and continuous expansion might be necessary in order to maintain the larger volume of world trade. Such credits are not suitable for a stabilization agency.

Much emphasis was placed on credits during the 1920's as a means for expanding foreign trade. A number of new institutions with imposing titles were organized to finance foreign trade in that period, but most of the capital invested was dissipated and the institutions soon disappeared.

There is not much in past experience to indicate that a large line of liberal credits will stimulate a healthy development in foreign trade, but there is a real danger that such credits might accelerate inflationary influences in the post-war period. The exchange troubles in the 1920's were not due to the lack of credits. In fact in many cases loans and credits were entirely too generous, with the result that long-run exchange difficulties were intensified.

The new plan still leaves rather vague the nature of its functions in the transition period. It is stated that the Fund is not intended to provide facilities for relief or reconstruction, or to deal with blocked belances. It is obvious, however, that the Fund is intended to be used in the transition period. Both the size of the Fund and the nature of the credit formula established indicate that debit balances might accumulate in the Fund over a period of years. There are no standards imposed to indicate that the credits could be used only for short-term or seasonal purposes. The use of the facilities during the transition period might easily lead to the exhaustion of available dellars and other credit currencies, with the consequent breakdown of operations.

Even if the Fund's credit facilities should be used to the limit, it is obvious that they would not be sufficient to take care of all the transition problems. The principal credits in that period must obviously come through other channels. The establishment of an \$8 billion fund, therefore, does not give much promise of free exchange markets or the quick establishment of equilibria in international accounts.

Currency stabilization is largely a matter of sound internal policies in each country. If fiscal and monetary policies are not in order, external credits cannot keep the currency at par with other currencies.

Inflation within and stability without are incompatible and cannot be achieved except through rigid exchange controls. We cannot get away from the fact that exchange stability is largely a problem for each individual country. The statement of principles by experts places very little emphasis upon the need for internal reform. In fact it specifically states that the Fund shall not refuse to permit a country to change the parity of its currency because of internal policies. This would seem antagonistic to the principle of exchange stability. It seems to suggest that the difficulties created by internal policies can be remedied by changing the parity of currencies, thereby throwing the burden of adjustment on other countries.

The writer's views regarding the proper approach to stabilization and the kind of international organization that should be established were set forth in an address before the Academy of Political Science on April 12, 1944 entitled "International Financial Organization." It is not necessary to restate those views here. The question might be raised, however, as to whether sufficient changes could be made in the statement of principles by the monetary experts to make it a workable and accept—able plan. Perhaps if the following changes could be effected the plan might be developed in such a way as to merit general acceptance:

- (1) Reduce the Fund to about \$2 billion.
- (2) Eliminate entirely the formula for granting credits on the basis of quotas, and permit the Fund to operate on the same principles as any sound banking institution.
- (3) Restrict the granting of credits to purely temporary or seasonal needs in the various money markets, always on the basis of prime collateral.

(4) Provide more specifically against the use of the Fund for extending long-term loans, for financing chronic debit balances, or for providing transition needs for relief, reconstruction or international indebtedness arising out of the war. These transition needs and longer-term credits must obviously be met in some other way.

(5) Eliminate provisions granting formal and official powers to the Fund to fix exchange rates or to approve or disapprove of changes in rates. These matters should be left to voluntary negotiation and agreement.

With these modifications such an institution could facilitate stabilization negotiations and agreements between individual countries, including necessary stabilization credits. The initial negotiations would presumably begin between some of the major countries and gradually extend to other nations.

- J. H. Riddle -

5/18/44

ORVILLE C. SANBORN

ATTORNEY & COUNSELOR 50 BROADWAY NEW YORK 4, N.Y.

WHITEHALL 4-4247

January 2, 1945.

Mr. Leon Fraser, 2 Wall Street, New York, N. Y.

Dear Mr. Fraser:

It was a great pleasure to receive your letter of April 28, 1944, commenting on my article, "Post-War Employment in the United States".

I am pleased to enclose a further article "Can Germany be Democratized?"

I should be exceedingly glad to have your comments on the suggestions contained in this paper.

Very sincerely yours,

Orville C. Sanborn

OCS:W Enclosure

CAN GERMANY BE DEMOCRATIZED?

рy

Orville C. Sanborn

Germany is the trouble child - or rather the trouble state - of Europe. This condition has been chronic since the days of Bismarck, a period of eighty years, but in fact extends back deep into German history.

Germany with its eighty million people is an intelligent and powerful nation. But it never has been democratic.

On the other hand the world of the United Nations must face the fact that until the German nation and people become essentially democratic, they will continue to disturb the peace of the world.

The situation nowhere has been stated better than by Professor Ralph Barton Perry of Harvard, who in a letter to The New York Times some months ago, said:

"The external conduct of a nation, however, cannot be separated. from its internal constitution. It will act outwardly as it is inwardly. If its government does not hesitate to oppress its own people, still less will it hesitate to oppress other peoples. The three Axis regimes furnish perfect illustrations of this fact."

To put the thought expressed by Professor Perry to practical application, is there any method whatever, by which an internal constitution of a democratic type can be established in Germany, and thereby tend to democratize her governmental tendencies, both internal and external?

This being a question of foremost importance to the entire world, it would seem that the concentrated thought of the United Nations should provide a solution. Nevertheless, this question arises: If an improved governmental status is to come from within Germany itself, will it ever come?

The answer is emphatically no, for the sufficient reason that the light of democracy does not now burn, and in fact never has burned in Germany. Germany, by political and historical background lacks both the fundamental instinct and necessary training, for the establishment and conduct by herself alone, of a successful and cooperative democracy.

There follows immediately the question as to what is the dominant requirement in the case of Germany. Is it to apply the principle of self-determination to a distinctly predatory nation, or is the dominant requirement rather to maintain the peace of the world?

Mr. Churchill has already stated that the principle of selfdetermination does not apply to Germany, and with that it seems the American people should agree.

After two world wars brought on within the short space of twenty-five years, and in all five predatory wars instigated within the last eighty years, it appears reasonably clear that Germany as a nation comes within the well-recognized penal theory which calls for both restraint and education. Education in the theory and practice of democracy; restraint until that education has taken root.

We are not at the moment discussing the strictly penal elements of punishment. We limit the discussion to the essential element of preventing another war. The American people do not care inherently whether Germany or someone else controls the Ruhr; whether Germany is left intact or partially dismembered, or other safeguards imposed. What the American people are fundamentally interested in is that Germany shall effectively be restrained from instigating another world war.

The monetary cost of this war can, within reason, be forecast. Its cost to the United States, if it terminates within a year, which is doubtful, will be approximately \$300,000,000.

That means that if the policing of Germany should cost \$3,000,000,000 a year to the United States alone, and if to prevent a further war it should be necessary that such policing be conducted for the next hundred years - an entire century - still that procedure would be justified, and financially profitable to the people of the United States.

The one thing that cannot be permitted is the instigation of a further world war by this predatory nation. There has been colossal destruction in five years of World War II, but that is not the sole criterion. It is the sound judgment of many well-informed military officials that if the robot bombs had been developed by Germany in sufficient numbers in 1940, Great Britain would have succumbed.

If Great Britain had fallen in 1940, then it is clear either that the United States alone would have been required to fight Germany, expanded into the whole of Europe, or else the war would have ended in a temporary stalemate while Germany did in fact integrate the industrial capacity of Europe for a supreme effort to enslave the entire world, including the United States. It is clear that the rocket bombs are the

outstanding individual development of this war, and they have been developed by Germany. Germany is a dangerous and predatory antagonist. Unquestionably, she must be restrained; if possible, educated.

The United States has done a stupendous job in the production of munitions and war materiel. Its outstanding achievements have been the creation and mass production of the flying fortress and other military aircraft; the design and production of the jeep; the development and production of the Sherman tank and other mounted armament; of trucks, tractors and mobile equipment, and lastly the amazing design and production of amphibious equipment.

But does the United States within the next hundred years want to be showered with rocket bombs manufactured in great quantities by Germany, and its peace and prosperity imperilled or destroyed? If not, let us have faith in our own institutions.

The great basic political institution of America is constitutional democracy, founded on the Anglo-Saxon Bill of Rights, as incorporated by the Founding Fathers into our Constitution.

This type of government has now been tested by the American people for 155 years since the enactment of the Constitution, and thereby has proven that it furnishes a governmental formula under which peoples of antagonistic races can work side by side, with industrial and political harmony, and that these people who have come to this country from every nation on the globe here have found peace, contentment, and financial prosperity.

In the meantime the residual people of Europe have continued to quarrel among themselves, and with everyone else. The reason is that the basic political status of these people is unsatisfactory. Can they evolve a satisfactory governmental status themselves? Probably not. But it exists and could be set up for them to their great benefit, and also to the tremendous benefit of everyone else, including the people of the United States. The solution is known as constitutional democracy. It exists in that form in the United States. It exists also in the British Commonwealth, notably in Canada, Australia, New Zealand, and the Union of South Africa. Also, in the form of a constitutional monarchy, in reality a democracy, in the mother country, Great Britain.

It exists for many practical purposes in a few European countries, notably Switzerland and Scandinavia.

But it does not exist, and never has existed in Germany, or generally throughout Continental Europe.

The origin of "constitutional democracy" is interesting to observe. It arose out of a custom of the Anglo-Saxon tribes to determine their governmental problems in open meetings of the clan. They were not subservient to a tribal head-man or king.

These Anglo-Saxon tribes, during the fifth and sixth centuries, conducted a mass migration to England. This was so effective that the indigent Romanized population was either destroyed or swept into Wales and Cornwall. Its institutions did not remain to affect the Anglo-Saxons. Therefore, instead of absorbing a Romanized civilization, they developed in their country in the next thousand years, a complete system of government and law, based on the so-called inherent rights of man. These principles were exemplified by Magna Carta, by many statutes of the early parliament of England, and by the Bill of Rights Act of 1689, by which the English parliament adopted the major tenets of the Bill of Rights, as incorporated in the American Constitution in 1789.

Exactly the opposite situation occurred on the continent of Europe. There Roman law, which had reached an advanced state of codification and development, known in its present form as the Code Napoleon, constitutes the prevailing law. It emanated from ancient Rome, which was a dictatorial state. Its central principle was the exhaltation of the state over the individual. It is imperialistic and repressive; not democratic.

Search and seizure by a centrally controlled police force, and other repressive practices have been routine on the continent of Europe throughout the ages.

It was this fundamental difference in governmental practice to which Jefferson referred in 1789, when he wrote to Madison:

"A Bill of Rights is what the people are entitled to against every government on earth."

Freedom-loving elements of Germany and other countries of Continental Europe have emigrated to the United States for the past century, and here found political freedom, contentment and the opportunity to work out their economic security, which had been denied at home.

They accordingly became an integral part of the great body of citizenship, leaving behind the burning antagonisms of their kindred and people.

It is contended by many that freedom cannot be transplanted; that it must come from within. But in forty years, from 1900 to 1940, in the Philippine Islands, the United States superimposed constitutional democracy upon a depressed form of the civil law of Continental Europe, and thereby implanted in an indigent people a love of freedom and democracy, which led the Filipino soldiers of Bataan to fight, bleed and die side by side with their American brothers. Nowhere else did this occur in the course of the Japanese invasion.

If the people of the United States do not want a further and more terrible world war, they must control at all costs, both Germany and Japan, the two distinctly predatory nations.

The necessary procedure would be somewhat as follows:

Incorporate an International Bill of Rights in the Peace Treaty, and if possible, in the Charter of the World International Organization. Thereby, proceed to establish the major principles of the Bill of Rights, as a fundamental part of international law. At least this should apply to all countries except Russia, and such satellite states as are to be included in its orbit.

These provisions should include the "Guaranties", as well as the "Freedoms".

The fundamental "Freedoms" of the American Constitution are Freedom of Speech (or Freedom of Expression as it is sometimes called) and Freedom of Religious Worship.

To these should be added at least four guaranties: the Guaranty of due process of law, or as its synonym sometimes is stated - the equal protection of the laws; the Guaranties against unjust search and seizure of persons and property, and against inhuman and cruel punishments. These outrages have been perpetrated for the last ten years in Nazi Germany to a greater extent than ever before in modern political history.

Also, the Guaranty against the taking or confiscation of private property for a public use, without just compensation.

Adolph Hitler rose to power in Germany by the confiscation of private property to his own illegal use. This oppression has been flagrant throughout the history of modern Germany. There is hardly a German national who has come to find asylum in the United States during the past hundred years, but might have stated his case somewhat thus: "They confiscated my family's property. I took what little I could save, and came to the United States".

The absence of enforceable provisions in the basic law of nations throughout the world, against confiscation of private property for a public use, probably is the cause of more political discontent of subjects of those countries, than any other single cause. Let this difficulty be eradicated.

Every enemy country which becomes subject to the jurisdiction of the Peace Conference should be provided with a written constitution of a democratic type and its enforcement should be supervised by the United Nations for a sufficient time to insure both familiarity and compliance with that form of government. This requirement applies particularly to Germany and Japan.

Furthermore, the attitude of the Christian peoples of the world must necessarily be different toward this problem since the disclosure of the Maidanek and other atrocities. It appears that these atrocities have been flagrantly perpetrated by Germany throughout the course of the war. It is not salutary that any nation be permitted to continue a course involving such wanton destruction of human life, either domestically or internationally.

In the name of humanity these proceedings must be stopped, and

if possible their motivating cause eradicated. Otherwise, they will debase the moral structure of the entire world.

If human life is not sacred in one country, then that virus will gradually seep throughout the world. It is our own lives, and those of our children, which we are protecting in opposing the type of government which permits such violations of decency and the sanctity of man.

The penalty to fail to provide these safeguards is a further world war.

Let the American people and their allies decide which they want:—
the necessary supervision to educate, provide and establish democratic governments in a democratic world, willing to follow governmental processes of good
will, or, in the alternative, to suffer the tragic recurrence of world war.

So far as Germany is concerned, the supervisory and educational power of constitutional government of a democratic type should be substituted, as far as possible, for military force. But the military force should be available, as long as it is required and until the German people give tangible evidence of conversion to democracy. There might be a relapse by Germany, even after the apparent acceptance of the tenets of democracy. But at least until its principles have been overtly accepted, the formula for dealing with Germany must be military occupation with adequate force, whether the necessary period be ten years or an entire century.

A United Nations Supreme Military Commander, as now contemplated - very likely General Eisenhower - would be appointed in supreme command of all civil and military authority. He would have the benefit of the advice of the United Nations Commission for Germany - also generally as contemplated in recent pronouncement of our State Department.

The Supreme Military Commander, acting under his war power based on military occupation, an authority long recognized by international law, would issue a proclamation extending the main provisions of the Bill of Rights and constitutional guaranties to occupied Germany. The proclamation of President McKinley, of April 7, 1900 - prepared by a great statesman, Elihu Root - by which these guaranties were extended to the Philippine Islands, might be considered as a precedent.

The Supreme Commander would issue a proclamation dissolving, and terminating all authority of, the German military staff.

The Allied Commission, subject to the overhead authority of the Supreme Military Commander, would exercise executive and legislative power. Then, after examining all available prototypes, it would prepare a constitution for a German Federated State, which would have one supreme requirement — it would be of a democratic type and would incorporate the Freedoms and Guaranties of the Bill of Rights.

It should divide Germany into separate states, and in this the historical organization of Germany should in general be followed. But Prussia should not be permitted to dominate the Reich as within the last

century. Prussia should be divided into component states of a size somewhat comparable to the other historical subdivisions. All political affiliation between the several states created out of Prussia should be abolished.

The Supreme Military Commander should then promulgate the Constitution of the German Federated State, as the supreme law of the land.

Constitutions also would be promulgated for each separate state, in all of which, both Federal and State, the main provisions of the Bill of Rights would be incorporated and provision made for executive, legislative and judicial branches of government.

This would be followed by the appointment by the Supreme Military Commander of governors for each state, thereby initiating the possibility of autonomous government in Germany. The governors appointed should be men of responsibility in their communities and men of good will. All Nazi affiliates would, of course, be excluded.

The judicial branches then would be set up and the legislative branches as soon as practicable. In the meantime, the Allied Commission for Germany would exercise necessary legislative powers. All these functions would be initiated under the overhead authority of the Supreme Allied Military Commander, who, by proclamations promulgating these proceedings, would reserve authority to veto laws adopted by any legislature, Federal or State.

The period of time during which the people of Germany would be subject to these controls would be entirely up to them. The United States maintained units of its Army and Navy in the Philippines for forty years, but the physical control of those units during the last fifteen or twenty years was chiefly nominal. The Filipino constabulary, established under the authority of the Philippine government, took over the function of police enforcement in the Philippines. It could be the same in Germany. During the period of military occupancy, the police force would, of course, be subject to the overhead control of the Supreme Military Commander.

To provide an adequate judicial system all appointments to judicial office should be made by the Supreme Military Commander. The courts should then begin to function. Each constitution, Federal and State, should contain the provision incorporated in the Statute of the Permanent Court of International Justice, to the effect that the judge or court would be required to write an opinion in each case. These opinions should be published, following the American and British practice, so that the people at large would have access to the operations of their courts. This would lead to acceptance of the principle of stare decisis, the principle that previous decisions on similar subjects may be cited as persuasive authority to any court, thereby building up a system of case law or judicial decisions, in the country.

It should be permissible, at the outset, for the Supreme Allied Commander to appoint judicial officers from the United Nations, particularly to Appellate Courts, or to the Supreme Appellate Court of the Reich, thereby to insure adequate review of constitutional and other questions until a system of democratic government should be adequately established.

The theory should be that the German people would be permitted consecutively to take over these functions as rapidly as they showed a desire and capacity so to do. It is clear that German nationals in the United States have become citizens of the finest type, and an integral part of our democratic way of life. There is no reason why they should not do so in Germany.

However, it should equally be clear that they will not initiate this process. It must be initiated from without. They have neither the desire nor perspective to do it themselves. In short, the German people with their predatory governments running back into the dawn of history, have no adequate conception of "democracy". They do not know what it means. Its working must be supervised until it is firmly established. In that case, the action of German nationals in the United States and the Philippine precedent, show that any predatory country with a civil law background in due course will espouse a system of democratic constitutional government.

This treatise, because of its limitations, will leave to others the determination of what territory actually should be incorporated in the Federated German democracy, and what parts with propriety may be put under the control of adjoining governments. However, this suggestion is made: that some of the major industries of Germany, as, for example, the state railways, the steel industry of the Ruhr, and similar enterprises manufacturing munitions of war (which activities must be denied to the German people in the future), might properly be placed under trust ownership and administered for an indefinite period under supervision of the Supreme Allied Military Command. An able, two-fisted administrator like Mr. Jeffers, who did such an excellent job in setting up our synthetic rubber industry, would soon bring order out of chaos on the German railroads. Furthermore, all elements of transportation and communications necessarily must be operated under the complete control of the Allied Military Command, as long as the occupation of Germany continues. The military occupation of Germany must continue as long as the world, under the leadership of the United Nations. wants - and is determined to have - surcease from world wars, buzz and rocket bombs fired at will into peacefully inclined nations, and other atrocities perpetrated by a predatory Germany upon defenseless or longsuffering humanity; or until Germany has become democratized, and has established a fundamental desire in the hearts of its people for stable government of a democratic type.

It may be a long time before this is accomplished, or the time may be shorter than anticipated. In any event, the result will be brought about only by setting up such a government and turning it over to the German people when and as, but not before, they are willing to accept the responsibility.

During the interval they will not be permitted to have a standing Army; a Navy; to manufacture munitions of war, aviation equipment or similar implements, which could be turned to the uses of war, with which to subjugate their fellow man.

For this reason, it is inherent that during this period the steel and other heavy industry of Germany must be under Allied control. This should be accomplished by taking such industries, including transportation, under operational management and charging to such operations, first, the expenses of the allied occupation of Germany; then with restitution for war damage - particularly to ravaged Continental countries, such as Poland, Belgium, Holland, Greece, Norway, France.

If this system is adopted, it is possible that the world might well be astounded at the relatively short time within which it would be possible to set up an operating democratic government in Germany, and the relatively slight use which would be required for armed force itself, to control Germany, Japan, or any other predatory nation.

It may be added that somewhat the same procedure (but for an entirely different reason), should be adopted for a depressed nation like Korea, which thereby would be given the form and structure of a government of constitutional democracy, to be turned over to the Koreans as an autonomous government, for their own benefit, as rapidly as they should be able to assume that responsibility.

Let the leaven of applied democracy, as used by the United States successfully in the Philippines, be the formula for the regeneration of both the predatory and backward nations of the world, for one great, all-controlling reason: the democratic people of the United States do not want buzz bombs and rocket bombs falling around their heads at any time whatever, and do not want their economy and the peace of the world disturbed by another world war. Also, it is obvious that it is cheaper and altogether preferable to set up an effective control over these predatory nations, coupled with constructive education in democracy, than to fight unrestrained despotism and unrestrained vandelism in recurring world wars.

It is clear, in any event, that one glorious and heartening comment may be made: No further tutelage, restraint or education will be necessary for the Philippines. The United States in 1900, immediately after the acquisition of those Islands, having established a government of constitutional democracy, that government has been made progressively autonomous for the benefit of the Filipino people. The result was that after setting up in their country a system of almost universal education, the Filipinos themselves advanced in learning and civilization until they were able to assume the responsibilities of that government.

Thus, by the steps taken by the American nation in its treatment of the Philippines, a beacon light was established in the principles of democracy. And, with this guidance, by 1941, the Filipino people were conducting a worthy prototype of "government of the people, by the people, for the people".

May it not be that these same principles can be used to advantage elsewhere, in order that, with our assistance and by the grace of the Almighty, freedom and democracy "shall not perish from the earth"?

Memorandum for -Randolph Burgess, Esq.

I have talked with Wolf and believe I have moderated him somewhat.

I have read your proposed report and would like to make two general comments; the first of which is that it seems to me that the pages which give your position on the Fund are not forceful, indeed a bit weak, and do not marshal in one place the principal arguments against the Fund, many of which are scattered throughout other parts of the paper and arise from implication rather than direct statement, and some seem to be omitted altogether.

As a practical matter, I think the Congressman who wants to refresh his memory about the reasons for the opposition to the Fund will turn back to pages 5 - 7, inclusive, and let it go at that. Hence these are vital pages.

Some of the basic reasons omitted in this place, or omitted altogether, seem to me to be the following, and I am not sure that I have not also omitted some basic reasons which are not of a merely captious or debating character:

- You do not sufficiently emphasize the prematurity of the scheme and how instead of being the first step, as Morganthau says in Foreign Affairs, it is the third or fourth, or last step. Indeed, there is some argument for simply postponing action on the Fund pending further developments. A lot of things have happened in the last few months which have changed the nature and magnitude of the problem.
- 2. The over-elaborateness and rigidity of the machinery established is bound to be vexatious in practice, particularly inasmuch as it is impossible as is attempted to foresee now in vacuo the problems which will arise. As you have put it, men and not machinery are what count.
- 3. While you deal with quotas, you omit this point (the practical argument of which will appeal to every business Congressman), namely, that quotas have been fixed for countries that probably have no need of them, and also fixed for others who may need them but will find them too small or that they really require more than 25% in one year and 0% in the next. In that connection, it may be dangerous to suggest that some of the quotas reflect political rather than economic considerations.
- 4. The Fund is based on the theory of credit expansion to develop world trade at a time when world trade is bound to develop anyway and when credit expansion in the world is likely to be too much instead of too little.

- The Fund implicitly recognizes what is, for the United States at least, a new continuing monetary philosophy, namely, fluctuating exchange rates within limits and the doctrine that adjustments to meet unpleasant conditions are not to be made by internal measures or corrections but by shifts in the exchange rate. Whatever is to be said for this new philosophy it is a change in our basic historic conception and Congress must carefully consider whether it is in the best long run interest of the United States. The essential requisite for international currency stability is to have one strong currency of a great country which is not considered subject to change, and that currency which can continue to be the world currency is the dollar. In entering into the proposed agreement, we are stating that the dollar, like the other currencies in the Fund, is subject to a ten or twenty percent change. To that extent, reflecting on its intrinsic stability and, in addition, agreeing that if any change should become necessary in an emergency, this could only be made by Congress with the consent of an international party.
- 6. Before Congress adopts the measure it should be assured that the same general interpretation is given to its text purposes and objectives in Great Britain as in the United States, otherwise the possibilities of disappointment and irritation are evident. The Congress should study the speech of Lord Keynes outlining his interpretation.
- 7. Are the bankers prepared to state whether or not they honestly believe the Fund will not work over the long pull, or give the desired results? If so, this should be said because it is the real heart of the problem. It is my personal view that it will break down if adopted in its present form and if ever asked to testify I shall say so but, of course, I cannot prove it.
- 8. One of the major defects of the global Fund approach is that it is based on the theoretical equality of all of the world's currencies, which is contrary to the fact. The fact is that the Fund will tend to be long of weaker currencies and short of the strong currencies, which may mean that after dollars are exhausted we shall be asked to supply more. The alternative of supplying more under the terms of the plan is to permit debtors to take discriminatory exchange measures against the dollar without making adjustments in their own economic or social arrangements which, according to Keynes, are exempt from criticism by the Fund.
- 9. The Fund explicitly permits bi-lateralism and recognizes regional currency arrangements and extended exchange controls, such as the sterling area, whereas our aim is multi-lateral arrangements which implies multi-lateral currency relationships.

You may not want to cover any of the foregoing points more explicitly at the spot mentioned but I hope you will give heed to my second general proposal and that is, to cut out the concluding para-

graph. This weakens the whole document because it is susceptible of the interpretation that it does not matter much what program is adopted. Don't you get the result by saying something like this at the end of the preceding paragraph - "We have confidence that Congress, after study and debate, will evolve a sound and constructive program and the country's bankers will, of course, loyally support the legislation in the form finally enacted"?

L.F.

File

POSTWAR PLANNING IN SWEDEN^X

I. The Postwar Economic Planning Commission.

This Commission, under the chairmanship of Professor Gunnar Myrdal, was appointed in February 1944. It consists of twentyone members, eleven of whom, including the chairman, are members of the Riksdag. Besides these representatives of the four main political parties, the Commission includes persons representing industry and labor, as well as the chairmen of the two organized groups that are parties to the labor market - the Employers' Association and the Trade Union Federation; in addition there are representatives of the Chambers of Commerce, the Cooperative movement, women's interests, agriculture, and the exporting industries. Dr. Ingvar Svennilson, director of the Institute for Industrial Research, and Dr. Richard Sterner, head of the Economic Secretariat of the Trade Union Federation, have been appointed expert advisers to the Commission. Planning Commission is not an executive body; its instructions are simply to draw up the main principles on which employment policy in Sweden may be based after the war.

II. Preliminary investigations.

Extensive investigations had already been carried out before the Postwar Planning Commission was appointed. These investigations, made under the supervision of the Ministry of Finance, and in very close collaboration with private industry and business, were purely fact-finding. The aim was to produce data on the basis of which the Commission could later frame policies for employment.

In view of the vital importance of the employment problem,

x Utredningar angående Ekonomisk Efterkrigsplanering VII: Statens Offentliga Utredningar 1944:57 - Studies submitted in 1944 by the Postwar Economic Planning Commission, and brought up to date by the Swedish Legation in Washington in January. Digitized for FRASER1945.

these investigations had to be conducted along very specific lines. In the main they sought to answer two questions: 1. How many workers will become available for employment in the immediate postwar period as a result of reduced production in the armament industries, or owing to the demobilization of conscripted soldiers? 2. What are the possibilities of finding employment for the labor thus released?

III. Assumptions as to the trend of business activity.

In order to be able to draw up plans the Commission had to start out from certain assumptions as to the probable development of the international business cycle in the years immediately following the war. The first phase, considered as likely to last six months after the cessation of hostilities in Europe, is expected to be one of general economic stagnation. It is thought that disorganization and upheavals on the European continent will prolong the present almost complete suspension of Sweden's import and export trade.

A heavy boom, the consequence of reconstruction work being started in Europe, is anticipated during the second phase. There will probably be a substantial rise in Swedish exports, the amount of the rise depending in all probability on the extent to which Swedish businessmen are prepared to sell on credit.

Developments during the third phase will depend mainly on whether the anticipated postwar boom in the United States can be prevented from degenerating into a depression or not. If a crisis develops in the United States, it is to be feared that Sweden will once again experience a depression similar to that of the 1930's.

IV. Supplies of raw materials.

The trend of business activity in Sweden during the postwar period will also depend, however, on the availability of raw materials. Particularly needed will be supplies of the three "strategic" commodities: coal and coke, commercial iron, rubber. Indeed, stocks of coal and coke are absolutely essential if the productive capacities of Swedish industry are to be

Digitized for FRASER http://fraser.stlouisfe**tial if the productive capacities of Swedish industry are to be**Federal Reserve Bank of St. Louis

used anything like to the full extent. Sweden's ability to maintain essential transport, e.g. of lumber from the forests or of building materials, will depend on the supply of rubber. Supplies of constructional iron will be necessary if building activity is to be kept at a high level; and as will be shown later, a high degree of building activity will be sine qua non if full employment is to be achieved in Sweden.

As there is reason to expect difficulties in obtaining supplies for some time after the collapse of Germany, the Commission has recommended, <u>inter alia</u>, that the present rationing arrangements for raw materials should continue in force for a certain period after the end of the war. It has also recommended that the production of certain substitutes be started, pointing out in this connection that it would be extremely dangerous to assume that imports of raw materials from overseas can be resumed immediately. Plans for acquiring supplies of raw materials must be so adapted that the country will not have to face postwar depression with its stockpiles practically exhausted.

V. Monetary policy.

There was considerable unanimity among the members of the Commission with regard to the country's monetary policy during the transitional period after the war. This should aim at (a) the stabilization of incomes at their present level, and (b) a gradual fall in the general price level.

Money incomes, and especially wages, are thus to remain unchanged. A general upward trend of wages would upset the price ceilings and could easily start inflation rolling.

To prevent rises in incomes during the last stages of the war will be no easy task. The Commission has therefore stressed the importance of taking steps as soon as possible to attain the second objective laid down in the program: a general fall in prices. The basic idea underlying the Commission's program is this: Those groups in the community which have suffered a reduction in real income during the war owing to prices having

standard, not through an increase in nominal money incomes, but through a lowering of the price level. In order that this reduction of prices may take place at the same rate as the inevitable decline in costs due to cheaper imports and to the abandonment of the highly expensive production of substitutes etc., the Commission emphasizes the importance of allowing free competition to function effectively. If this should prove insufficient, however, the Commission proposes that the Price Control Board be empowered to reduce prices by order. The Commission is nevertheless unanimous in the opinion that price controls - and also the rationing of goods - should be drepped at the earliest possible date.

VI. Trade and foreign exchange policy.

Sweden's predominant interest, the Commission emphasizes, lies in free international trade. The Commission has, moreover, clearly and definitely expressed itself in favor of the international stabilization of foreign exchanges. Sweden should even be prepared to accept payment for her exports at relatively unfavorable rates of exchange, if general stabilization would thereby be furthered.

The Commission is of the opinion that Sweden should consider the adjustment, upward or downward, of the prevailing exchange rates only in two contingencies:

- a. If a surge of inflation in the larger countries should threaten to spread to Sweden. Sweden would then have to increase the external value of her currency in order to avoid becoming involved.
- b. If a serious depression should develop abroad, accompanied by a heavy fall in prices. In such case Sweden might have to face an over-evaluation of her currency which, until corrected, would tend to spread the depressive influences more severely and directly to the Swedish domestic market.

VII. Exports.

Sweden thus does not intend to use the weapon of exchange manipulation in order to assist her exporting industries. Other

ways of maintaining employment in these industries in times of depression have therefore been considered by the Commission. It has examined the possibilities of inducing private enterprise to keep on producing in such times in order to build up stocks. This line has been followed particularly with regard to the first phase of the probable postwar business cycle, the period in which for various reasons Sweden will have very little possibility of exporting and when unemployment might be considerable. The method is considered feasible, as it is anticipated that the demand for Swedish export goods during the following period, when reconstruction has got underway, will be so heavy that whatever stocks may have been accumulated will easily find a market.

VIII. Investments.

A great deal of attention has been paid by the Commission to the subject of investments, which after exports are the other great factor affecting business activity in Sweden. But whereas the volume of exports can be influenced only to a very small extent by decisions taken in Sweden itself, the possibilities of influencing investments are quite considerable.

The general objective of any measures designed to influence investments is declared to be the <u>stabilization</u> of such activities in order to eliminate, as far as possible, the fluctuations that otherwise always arise in connection with the cyclical trends of business activity. A secondary aim is to offset an incipient decline in exports by bringing about an increase in domestic investment activity as soon as the trend becomes evident. The possibilities of increasing the volume of investments during a business recession naturally vary according to the nature of the proposed investments.

a. Public investments in buildings and works projects of various kinds. the form of public works. Such activity has frequently, however, been in the nature of pure relief work, the social and economic benefit of which has been minimal. Or else the schemes have been so badly planned as to amount to mere improvisations. In either case the result has been a waste of economic resources.

The Ministry of Finance has therefore had an inventory drawn up by the local authorities throughout the country and by the State-owned economic undertakings, listing the various useful public works schemes that might be resorted to in order to provide employment in a crisis. The "investment reserve" compiled in this way is to be the equivalent of about two years of normal investment requirements, but it is to be so carefully prepared and minutely planned as to be capable of complete utilization within a year. In selecting the public works schemes particular attention is being paid to the ability of each project to contribute rapidly towards increasing the national income.

It is proposed that the task of coordinating public investments be entrusted to a new body called the <u>Investment</u>

Planning Committee. Regular reports on the investment requirements of State undertakings and local authorities will have to be submitted to this committee, so that investment reserves may be successively replenished as they are drawn upon for putting certain public works schemes into operation.

b. Industrial investments.

The possibilities are much more limited when it comes to leveling out business, and particularly industrial investments. In time of boom, a businessman can hardly be expected to postpone expanding his business until a depression comes. Nor is it desirable on the other hand, that industry should try to anticipate, in time of depression, the investments it will need to make during the ensuing boom period: the rapidity of technical progress makes any such anticipatory action altogether too risky.

Certain possibilities do exist however for leveling out

industrial investment activities to a greater extent than has been done in the past. Certain kinds of repair and maintenance work, and also the construction of office buildings, for instance, lend themselves to regulation in this way. The Commission is examining the prospects of being able to induce industrialists to undertake voluntarily at least partial adjustments in this direction. For this purpose a special Investment Council, consisting of representatives of industry and government, has been set up. Its task is to observe the trend of business activity and make recommendations to industry on the basis of its findings. In other words it is not a planning body endowed with executive authority. It can only try to induce industry, in time of depression, to make certain investments.

Other methods of influencing industrial investment activities during periods of depression have also been investigated. Mention need only be made here of the various forms of incentive taxation, i.e. putting a premium, by way of tax rebates etc., on investments made at times when business conditions generally are bad.

c. Housing construction.

Unlike the plans for using public investments to combat unemployment in time of depression, the plans for the production of dwellings do not envisage expansion or contraction of the building industry in accordance with the general employment situation. The intention is rather to stabilize production at a steady, high level. The objective aimed at is 45,000 dwellings per annum.

Whether this objective can be attained depends, among other things, on an adequate supply of coal for the building materials industry and of constructional iron, as well as of tires for trucks to transport building materials. If it can be attained, the present shortage of housing will be remedied in about three years. With the gradual decline in population, the formation of new households will then not be sufficient to maintain dwelling construction at the rate of 45,000 a year. It will be necessary instead gradually to increase the size of

apartments from the present average of about three rooms (including kitchen). But even this will not suffice to sustain employment in the building trade. In addition, the demolition of old buildings will have to be accelerated, in necessary by means of drastic measures. Otherwise the demand for new dwellings will not keep pace with the high rate of production staked out for the industry.

IX. Measures aimed at promoting consumption.

Government measures to combat unemployment have in the past to a large extent consisted of capital construction projects of various kinds. Caution must be exercised, however, in using this method of attacking the problem. What happens in a depression is that industries stand still. In many cases it is irrational to transfer the labor thus released to jobs which may even include the construction of still more facilities for industrial production. Such measures may easily put the social economic system out of gear. It would obviously be better, from many points of view, to keep normal production going.

The possibility of adopting measures to sustain consumption, in combination with other means of combating unemployment, has therefore been considered by the Commission. It is in particular the demand for durable consumption goods - furniture, refrigerators, electrical apparatus, clothing, etc. - which tends to fall off during a depression. The Commission has accordingly examined the proposal to grant subsidies for special production to help meet the demand on the part of la rge families for furniture. clothing, footwear, etc., which they would otherwise be unable to afford. Similarly stress has been laid on the desirability of stepping up the mechanization of agriculture during a recession. This would provide employment for the machine industry, portions of which would otherwise stand idle. The Commission has further proposed that this process of mechanization be encouraged by means of government-subsidized discounts and other similar measures.

X. Compensatory measures in labor market adjustments.

Special attention has been paid by the Commission to the organization of the labor market, the mobility of labor, and special training arrangements and compensation for unemployed workers. Measures under consideration include shortening of daily working hours during a slump, and the coordination of education policies with the general economic policy so as to provide expanded schooling and training facilities in times of unemployment. The adoption of specific policies for cash unemployment compensation has been suggested by the Commission in a special report, which recommends that compensation be high enough to cover the minimum costs of a standard of living that will provide for all the normal requirements of health and nutrition. Finally, the Commission has examined the whole problem of adjusting social policies to the general economic policy.

XI. Various fields covered by sub-committees.

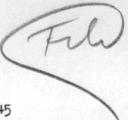
In order to deal with the various aspects of postwar planning the Commission has divided up into nine subcommittees. The following list of these sub-committees indicates the various fields covered and illustrates the scope of the problems with which the Postwar Planning Commission is dealing:

- o Monetary and Foreign Trade Problems
- o Planning and Organization of Employment
- o Mobility etc. of Labor
- o Expansion of Consumption and the Control of Quality
- o Unemployment Compensation

- Raw Materials
- o Housing
- o Agriculture
- o Control of Monopolies

Washington, February 1, 1945.

UNIVERSITY OF MICHIGAN ANN ARBOR



March 13, 1945

DEPARTMENT OF CIVIL ENGINEERING

Mr. Leon Fraser President First National Bank 2 Wall Street New York, N' Y.

Dear Sir:

At the suggestion of Mr. Otis Peabody Swift,
I am sending you a mimeographed copy of some unedited notes
on "Meeting Our Postwar Debt." If you are sufficiently interested
I would appreciate any comments you may wish to make upon this
subject.

Very truly yours,

John S. Worley

Professor of Transportation Engineering

MEETING OUR POSTWAR DEBT.

John S. Worley
Professor of Transportation Engineering
University of Michigan

Ann Arbor, Michigan January, 1945

INTRODUCTORY STATEMENT

Wanting to know more about our postwar debt, particularly with reference to the manner in which it could be paid, I thought a good plan would be to frame a series of questions, answers to which would give me the information sought. In framing these questions I experienced a great deal of difficulty in that in nearly every instance I was uncertain that the questions would produce comprehensive answers. This was due to my being not sufficiently informed. This led to a fairly extensive study, preparatory to framing questions, out of which to my surprise I found answers to my queries. I now revert to my early situation excepting that instead of asking the questions, I am presenting the information found, with the thought that wherever it is in error a correction will be the answer which I was first seeking.

I am not unmindful that certain words may have been used in not the most pure and technical economic sense, however, it is my belief that this in no way will affect the final conclusion.

It is hoped that whoever has occasion to read this memorandum will point out the errors of any statement found, furnishing the correct answer.

This memorandum is not to be published for fear of adverse effects upon the Government's present plan for financing the war.

MEETING OUR POSTWAR DEBT

I am not a real, neo, or pseudo economist. What knowledge
I have of the subject is that of the ordinary citizen, whose life is an
integral part of our domestic economy. Where seek a phenomenon is so much
a part of and important to the individual's daily life, it would appear that
he would have certain fundamental understandings and it is from this viewpoint that this paper is written.

Governmental Economy.

It apparently has been the thought of some of those who have made and administered the financial policies of our national government that they are analogous to those of private business. Studies I have been able to make raise some question as to the accuracy of such conclusions.

It cannot be too strongly emphasised that a government possesses no or at least a modicum of wealth. (1) Should someone call attention that in recent years the United States has invested in public works and war plants \$15 to \$20 billion and possesses some \$23 billions in gold and silver coin and bullion, therefore the United States does possess wealth of some moment, may we call attention that IOU s - U. S. Bonds - still outstanding were used as payment for these properties. Ownership under these conditions is not evidence of government net wealth.

[&]quot;The material wealth of a nation is its wheat, factories, railroads, mines, forests. From the communal standpoint, money is wealth only in so far as it is made of metal, which is wealth as such." (Money. Wm. T. Foster and Waddill Catchings. p. 20)

During World War I our "nation as a whole exchanged vast stores of real wealth - machines, ships, chemicals and so forth, used up in the War - for paper evidences of debt." (Money, Wm. T. Foster and Waddill Catchings, p. 21) Under certain circumstances this might be considered wealth.

Wherever a government enters into a transaction with another it simply is an entrepreneur and the considerations of the transactions are in reality those of the citizens as national groups. And where there is a similar financial transaction between the Federal government and one of the states or between the states - the same situation prevails.

Where a government enters into some internal financial transaction in which all the people, or at least a majority are interested and receive benefits, the funds which are necessary come from all or a majority of the people.

A government having no wealth of its own and having to meet a due obligation it is necessary that it secure the funds from its citizens either through direct taxation, a new issue of currency, or certificates of government indebtedness.

Transactions of a similar nature wholly within a state seem to fall within the same category, the characteristics of which are much different from that of transactions between two or more citizens.

Citizens, not governments, are the real creditors and debtors.

From the foregoing it is seen that internal public debts are quite different from those between citizens.

Wealth can be created internally by making available or by the development of the national resources. There is increase in wealth through internal commerce. The wealth of a nation may increase through commerce with other nations.

Our Monetary System.

admitted as pure speculation, however, it is reasonable to assume that in the beginning man sought and partook solely of the things of nature as he found the needs of the day required. Once satisfied he abandoned what remained of food or any other commodity. And it seems reasonable to assume that a day come when having a remainder he did not want, he exchanged with another for a thing he did want. Here we have, in the embryo, the origin of private business.

efficient and preferred to devote their energies, exclusively to making arrowheads, accessins, hunting and fishing, or special work which would provide some of the wants of society. Boubtless in time conditions arose and such special relationships were established between those who bartered regularly that a system of credit was created. In these transactions and the subsequent development of commerce it was found that persons would possess a surplus of goods which were wented by another who did not have acceptable goods to offer in exchange, however a third, or fourth, or fifth party may have possessed the particular commodity desired. By numerous barterings the thing sought could be obtained finally, however commodities passing through many hands became a cumbersome procedure which resulted in the invention and authorization by the government of money (2) which is nothing more nor less than a convenient mechanism of commerce.

The term money will be used throughout this discussion, in accordance with the everyday practice of businessmen, to cover not only all forms of surrency, but bank credits as well. By bank credit is meant deposits transferable by check. It is important to bear in mind, in connection with all that follows, that the term money is always used as synonymous with circulating purchasing power, and always includes both currency and bank credit, as defined above. (Money, Wm. T. Foster and Waddill Catchings. p. 15) Bank checks may be considered as money often serving the purposes of currency.

Through many decades of evolution we have finally arrived at our present monetary system with its banks and banking practices whereby numerous transactions occur without the physical exchange of goods or the direct use of currency. (3) In lieu of barter or payment of currency one may make payment for something he is purchasing through an order (bank check) on a bank where he has at a previous date deposited currency or its equivalent. This system has grown until at the present time individuals, companies and corporations have on deposit in the banks of the United States as of June 30, 1940, something more than \$60 billion while the national currency as of June 30, 1943 was a little over \$25 billion. It is this banking system which has made possible the enormous development of commerce with a small issue of currency.

⁽³⁾ Currency is "anything that is (1) passed from hand to hand throughout a community in payment for cosmodities and services, and (2) regularly taken with the intention of offering it in payment to others, and (3) customarily received without assay or other special test of quality or quantity, and (4) received without reference to or reliance upon the personal credit of the one who offers it. " (Money. Wm. T. Foster and Waddill Catchings. p. 17)

The collection of taxes by the government and the payment of government debt evidenced by bonds or otherwise, is done, as a rule, through our present monetary system without the actual use of currency. It is, however, absolutely necessary that the tax payer have credit units on deposit in the bank at the time he gives an order to the bank to pay to the government the amount of his taxes. Upon receipt of the order the specified amount government deposits the cartificate with the bank, to the credit of the government's account. The government in turn issues a voucher to the creditor citizen authorising the bank to pay from the government deposits the amount of the indebtedness. The creditor citizen in turn deposits the government certificate in the bank to his own credit - at no time is Currency actually used. It is absolutely necessary, however that the taxpayer have money on deposit in the bank prior to issuing his certificate of payment to the government. In turn it is necessary that the government have on deposit with the bank the amount of its certificate issued to the areditor, in payment of its indebtedness.

Noney is a Valuable tool for the distribution of production.

It provides a flexibility to our domestic economy permitting a freer and greater opportunity of choice in the acquiring or disposing of goods and services. Gold or silver, as coin or bullion, particularly gold, has but little intrinsic value.

The Velocity of Money.

One element which greatly influences the national income is the rate of flow of money into the Gustomers' hands which they use for the purchase of consumers' goods. The velocity of money is not dependent entirely upon the purchase of consumers' goods. Money may be used for some other purpose as in the late 1920s when there was unprecedented trading of securities on the stock market. In this case there was a rapid velocity of money particularly in New York state, which, however, did not contribute in any way to employment and the national income. Bank clearings under normal conditions are indicative of the velocity of money.

For the years of 1939 and 1940 these were \$290.2 and \$296.6 billion respectively, which approximated a turnover of five times per year.

Where money is collected as taxes by the state or federal government to meet long term indebtedness this tends to greatly reduce the velocity of the money used. The citizen knowing that taxes must be paid on a certain date, accumulates and hoards the necessary funds to some extent. There is a lapse of time between the date when the government receives the funds and the payment to the citizen creditor. A considerable portion received by the citizen creditor will be held as savings. For the remainder there is a considerable lapse of time from the date he receives it until he returns it to our stream of production. If the volume of circulating medium remains constant any retardation in the velocity of money reduces the national income and profits, and unemployment is increased.

Where money is collected as taxes which is paid to citizens on relief, this is used at once for the purchase of consumers' goods in which case there is no slowing down of the velocity of money or a later reflection in the national income. Belief expenditures are current cost which should be met as of the time incurred, otherwise the national income of later years will be affected.

Money collected as taxes to meet normal annual government expenses will return at once to the stream of production and will not slow down the velocity of money.

The Nature of the National Debt.

A national debt is usually incurred where a country is engaged in war or an unusual expenditure for large public works or for relief during serious depression. As a result the debt may become of such magnitude that great difficulty may be encountered in its later liquidation. A wasteful unsound financial policy may lead to a national debt of a size causing financial embarrassment.

Expenditure of public funds, as a rule, are non-income transactions and in the case of war may be considered expendables as of the year
incurred. A sound financial policy requires that current expenditures be
made from current income.

The parties of interest in the national debt are the creditors and the citizenry collectively, as the debtors, the government, acting through its official representatives, as an entrepreneur. The debt may be external or internal. If the debt is external the creditors may be the citizenry of some nation with its government as the entrepreneur or individual citizens who have made loans direct. Should the external debt be not liquidated according to its terms, an attempt may be made to collect through military or other forms of coercion which may ultimately lead to war, the success in the collection of the debt depending upon the final outcome of the conflict.

An internal public debt arises where a certain group of citizens have become creditors to the citizenry as a whole, the government through its authorized agents being an entrepreneur.

War expenditures are total losses, payment of which is often deferred to some later date. It is more realistic to say that all war expenditures - total losses - become immediately the debt of the collective

citizenry. Where current payments for the production of war material are internal, the citizenry enjoying apparent prosperity, this can be said to be nothing more than deferred payments of losses. War prosperity is fleeting and if war is continued it will eventually bankrupt the nation.

The following abridged table shows our national debt from 1791 to date.

PUBLIC DEBT UNITED STATES

Year	Amount (000)	Per Capita	Year	Amount (000)	Per Capita
1791 1806 1812 1816 1835 1861 1866 1870 1880	\$ 75,46 87.00 45.00 127.33 40.38 2,332.33 2,436.45 2.090.90 1,122,39	13.46 5.83 14.90 37 0.02 30 2.81 63.91 63.19 08 41.69	1900 1910 1915 1918 * 1919 1920 1925 **1930 1935 1940 ***1950	1,263,416 1,146,939 1,191,264 12,243,028 25,482,034 24,297,918 20,516,272 16,185,308 28,700,892 42,967,531 300,000,000	16.56 12.69 11.63 115.65 246.09 228.32 177.82 131.38 225.71 325.19 2,134,26 2,845,62

^{*} High following World War I

Government borrowing to meet the capital cost of a revenue*
earning property will in no way affect adversely a government's finances or
its ability to meet its debts providing the annual earnings justifying the cost.

^{**} Low following World War I

^{***} Estimated

Fiscal Matters.

A brief review of the manner in which the present war is being financed may be of some aid in a better understanding of our postwar debt problems.

At regular intervals the government offers for sale a certain amount of war bonds. Having disposed of the maximum amount possible to private individuals, insurance companies, trust companies, and other private corporations, the unseld remainder is delivered to the banks, the government receiving credit as deposits the current value of the bonds. From these deposits the government meets current war expenditures. Defore these deposits are entirely used up another wer loom is negotiated. This results in the financial statements of the banks showing as ingresse in essets and in liabilities. Should a elivation arise whereby the bauks would not be able to meet the demands of their private depositors the banks may present a part or all of the bonds held, to the Federal Reserve Bank, which it has suthority to purchase, by issuing federal reserve notes. This latter, of course, is a direct sidition to our coursely, resulting in inflation. The Series E bonds parchased by individuals way be taken to the banks at any time and cashed at their current value. All other bonds held by individuals, trust companies, insurance companies, and either private dorporations, will not be redeemed by the Government until their due date. If the Government at any ties finds it has neither surreasy nor evodit to meet the obligation it can do so by a relegue of bonds,

In addition to funds obtained as above there is now (1944-45) being printed and issued, paper surreacy at an average rate of \$500,000,000 per south.

An interesting situation in connection with our fiscal affairs is that the billions of dollars collected for old age pensions, social

security, and other similar items have been used for current general expenses or conduct of the war. The trustees of these funds have been given government bonds in lieu of funds. When the time arises to meet their obligations the trustees, having no assets excepting government bonds, must sell them to the public, the interest and principle of these bonds being paid through current taxation of the general public.

A great deal has been said about paying the war debt from the profits of a large national income (4) ranging from \$140 to \$200 billion per year. In the liquidation of war bonds from such annual profits, only a small part received by the creditor will come back into our stream of annual production; and other will be held as savings from which it is immediately evident that for the national income of the next year to equal that of the past, capital assets will have to be used. This might continue for two successive years but eventually there would be a drop in the national income. From this it appears quite obvious that the people of a nation cannot have an income from operations - production and consumption - which can be drawn off through texation to meet the postwar debt. The income of everyone in a particular year must be used the coming year to purchase the production of everyone else otherwise there is a fall in the national income.

[&]quot;National income may be briefly defined as the returns to the people during a given year for the work they do and for the productive use of property or capital which they own," - all the "forms of income as income accruing to individuals and the combined total for a given year as the national income. This conforms to the usage of the Department of Commerce." (Postwar National Income. Joseph Mayer, 1944, pp. 4 and 5)

In 1492 there was contained in the now geographical boundaries of the United States all of its present natural resources which are a part of our today's wealth. Our remaining wealth consists mainly of natural resources which have been processed and organized into a domestic according.

from 1492 to 1944 over a period of 452 years our wealth increased from nothing to \$350 billion. From 1940 to the end of the war, or until the end of the reconversion period, say 1950, our national debt will have increased from \$43 to \$300 and possibly \$400 billion. \$400 billion as the probable amount is now being mentioned by some economists and political scientists. Since 1786, when the United States was organized, to date, it has never been free of public debt. However, in 1835, the national debt was reduced to \$37,000.

Mowhere in history is it recorded that any government ever paid a large war debt. It is physically impossible.

The average annual increase in bank deposits might be thought as being available to meet a due debt. This increase, for twenty-one years 1920 to 1940 inclusive, averaged only \$1.5 billion per year. This is sufficient to pay only one-fifth of the annual interest to say nothing of reducing the \$300 to \$400 billion.

The large annual increase in bank deposits for the years 1941, 1942 and 1943 over preceding years is strong evidence of a previous statement that war prosperity was only apparent and not real and that supposed profits only represented current uspaid war costs.

During the period 1936 to 1940 inclusive, the average federal tax collection was ever \$12 billion a year, which failed by nearly \$2 billion per year to meet annual government expenditures. Taking our debt at the close of the war as \$300 billion at an average interest rate of 2½ percent, to amortise the principal in 30 equal annual payments and meet the annual interest would require \$16,263 million a year. The interest alone would amount to \$7,500 million a year. To this add the average annual tax collection necessary to meet average annual normal government expenses for five years just preceding the war we have an annual postwar tax burden of \$30 billion. This does not reflect any large expenditure for unemployment which may follow this present world catastrophs, neither does it include large sums which it is proposed to spend for additional social security, sanitation, health, education, and other desirable items. There are other fiscal factors of less amounts and importance which have been omitted, but it is thought that will approximately balance each other.

A postwar debt of \$300 billion emounts to an average of \$6,500 against every family in the nation, rich and poor, high and low, black and white.

The winning of the war being paramount to our political and economic existence, no question can be raised with reference to any legitimate expense necessary thereto. It is hoped that the waste will be held to the minimum. Next to winning the war, a matter of great importance to the average citizen is meeting the public debin the postwar period. A number

Digitized for FRASER of plans have been proposed whereby this can be done, each of which may have http://fraser.stlouisfed.org/s different pattern.

Federal Reserve Bank of St. Louis

Reparations.

Production in peace time has as its sole objective the providing society with food, clothing and shelter. Where there is an overproduction of a particular commodity it is for the purpose of export to obtain a good wanted. There can be no other use of overproduction.

The world's production in the long run has never exceeded its consumption. It is said upon good authority that two-thirds of the world's population is always hungry and in our own country it is said that nearly one-fourth of our population is never without hunger.

In order for the enemy to meet all or a part of our public debt through reparations it is necessary that this amount be taken from his production. This would have to some primarily from Germany whose population will probably not exceed 90,000,000 persons. To pay the reparations would mean that Germany must have a surplus of production over the meager useds of its people. We will demand probably that reparations be paid in gold for otherwise if paid in goods it would be necessary for the United States to market the goods prior to having funds with which to meet annual debt service and retire our \$300 billion debt. It would not seem reasonable to expect that Germany if she were able to have a surplus over her consumption could find a market where she could sell for gold with which to make reparation payments. Attention is called that in most of the countries the payment in currency for foreign purchases or the expert of gold by private individuals is prohibited,

At the close of the war our enemies will probably be bankrupt.

They will have no wealth with which to meet reparations and their internal debt will be so great it is to be expected it would be impossible to secure funds by any form of taxation or bond issues, and if they did, gold necessary to make payments would not be available.

After the last war Germany was not able to meet the reparation payments and our allies did not repay funds borrowed from us.

It would appear physically impossible for our defeated enemies to contribute material amounts toward the liquidation of our \$300 billion war debt, neither can we expect the payment of debts owed by our allies.

Inflation.

With inflation (5) comes the devaluation of national currency. This means that a unit of currency will purchase less or the opposite thereof being that prices are higher. As inflation advances, prices of labor, goods, and services, advance fairly uniformly. Contract obligations made prior to inflation are met in accordance with the terms thereof, no consideration being given to the change in currency values. Creditor citisens are paid with devaluated currency. As inflation progresses and there is a devaluation of currency it can readily be seen that the public debt is easily liquidated, the creditors thereof being heavy losers. Following the last World War when inflation got entirely out of hand in Germany, that country found no difficulty in liquidating its internal debt.

Looking at it from a narrow viewpoint it might be said that from the standpoint of the general public this would be advantageous, however from the standpoint of the citizen creditors it would be disastrous.

⁽⁵⁾ Inflation as used in this discussion denotes any increase in the volume of money that is accompanied by the rise in the general price level.

Repudiation

Repudiation of the mational debt simply means a refusal of
the national government to meet its obligation. As a rule where a
situation of this kind arises it comes about by the demise of an old
government and the organization of a new one. The new takes possession
of all the assets of the old, establishes rules and regulations advantageous to its ideologies but rejects all liabilities of the old. This was
the situation in Bussia following the last World War when the old Czarist
government was replaced by the new government. The new refused to recognise
or liquidate any of the debts of the old.

It is easy to conceive that a ponderable public debt could become so burdensome as to become a serious handloap or an absolute barrier to seconomic recovery. Commerce might be greatly benefitted by repudiation. Producers being free of heavy taxation would be in a position to move forward towards building new businesses with large production and markets. Where the debt was solely internal repudiation would not cause any loss in mational wealth but would be a redistribution of existing wealth.

One bad feature in commetion with such a proposal is planting within the minds of many that public and private debts could be repudiated when it was no longer convenient to make payments. Such a program and attitude is not in keeping with high character, which is necessary to a free people and a lasting government.

Refunding.

It has been suggested that no attempt should be made to liquidate the public debt and to meet this situation that there be frequent refundings with a reduction in the interest rate at each new refunding. Eventually the bonds themselves would decrease in value until they could finally be liquidated. This program over a long period of years would be equivalent to slow repudiation and would cause less hardship than repudiation or inflation.

War Bonds in Payment of Taxes.

There is another possibility of meeting the national debt to which attention is called. The war bonds have been rather widely distributed. If a program could be adopted with a provision that a part or all of the annual taxes for the purpose of meeting the national debt be paid in war bonds, a situation would then be created whereby war bonds could be accepted for taxes. This would not require currency to meet the amount of taxes assessed for the war debt. Careful study might develop the practicability of a discount in taxes to all those who paid the same in war bonds. Taxes for other governmental purposes, of course, would have to be in currency.

Inheritance Taxes.

The appropriation of a large part of the estate of deceased through inheritance taxes would be another means of liquidating a considerable portion, if not all of, the war debt. This combined with one or more of other suggestions which have been made might provide a solution pituation.

to this structure. It would result in a redistribution of the wealth of the nation the same as every other proposal to meet the debt through internal revenue.

Liquidation in Small Annual Increments.

Another proposal for liquidating our war debt provides that each year \$1 billion would be paid. Such a program would require a period of 300 years to liquidate the whole debt. Interest during this period at the low rate of 2 percent would amount to three times the amount of the principle. The American public is a people who do not look kindly upon either large unliquidated private or public debt and would doubtlessly reject such a program. Further, the demands of the future, including the possibility of another war, make questionable the desirability of such a plan.

Liquidation by Repudiation Through Fixed Annual Increments.

Just the opposite of the foregoing is found in the suggestion that beginning immediately at the close of the war, a program be adopted whereby each year bonds in an amount of \$10 billion be redesmed with a special type of currency, which currency would be legal tender for a period of only ten years. By this process, the whole debt would be liquidated within 40 years.

Bonds With No Maturity.

One way of meeting the dilemma of an unprecedented national debt would be to refund the whole debt with bonds of no maturity date with a low interest rate say of \$\frac{1}{2}\$ of 1 percent. The British have a similar form of certificates of indebtedness with an average interest rate of 2\frac{1}{2}\$ percent.

Such a procedure would provide in perpetuity some income for the holders of the bonds. It would relieve the citizenry of a burden which it would appear they could not carry and would be an incentive to a prosperous domestic economy and full employment. Such a program should be sufficiently controlled as to not permit undue inflation.

Meeting the Postwar Debt from Profits of Internal Commerce.

It is a popular concept and generally accepted that, without inflation, the postwar national debt can be paid from the profits of an annual national income of \$150 billion to \$200 billion. Such a large national income, of course, contemplates a large production which will be marketed either abroad or internally.

The dagree to which our production can be marketed in any foreign country will very largely depend upon the amount of goods its merchants can sell us which probably will be upon a barter and exchange basis. We will not be able to dispose of these goods for currency which is necessary in meeting domestic taxes. The sale of our production in foreign markets from which funds will ultimately be realised with which to pay the postwar debt does not appear to have a great deal of probability.

Internal commerce consists of the production and sale of goods and services. This occurred in early times, as has been pointed out, through barter and exchange, which directly or indirectly is the basis of all present day transactions. This process has been made more flexible through our monetary system.

The usual current procedure is through sale, not barter or exchange. The proceeds are deposited in a bank from which funds are drawn to meet the cost of production. Any surplus is profit. Hecessary to this procedure must be a market representing the purchasing power which somes from the production of either goods or services, from which we see that for each volume of production, goods or services there must be another equivalent volume of production. And where business transactions are through the convenience of our monetary system the profits do not remain in the banks

as deposite. They move on to purchase the surplus (profits) of some other production. Profits pass from goods and services to credit units, deposits in the banks, back to surplus of production. This is necessary that each producer may be able to dispose of his surplus production. Where we have innumerable business transactions the profits may rest in the banks for a brief interval of time which may make it appear that a credit surplus (profit) may be available with which to pay taxes.

The internal purchase of any production is by funds from the
sale of some other production whereby there is no surplus funds for tax
payments. The profits of the producers as a group come from the consumers
as a group. In order that the consumers purchase an equal amount for the
coming year all they paid out this current year must be returned to them.
The production and sales are equal and in balance at all times. This can
be said to be a truism. From which it is quite obvious that even with a
large national imcome due to large production where there is no inflation
there is no surplus funds with which to meet a large war debt by tax assessments.

It may be claimed that such a conclusion is fallacious for the reason that at the present time governments do assess taxes against citizens for normal annual expense. The answer to this is that taxes paid to governments to meet normal annual expense go largely to individuals as salaries and expenses who use these funds for the purchase of services and products of others returning the money to the current stream of production.

And where taxes are paid from profits which in turn go to meet the postwar debt, only a small part of the payments return immediately to the stream of production of goods and services. This results in a reduction in potential national income. The creditor citizen largely invests these payments in fixed assets or keeps them in some form of savings which tends toward inflation.

Should an internal situation exist whereby a limited number of commercial concerns earn a profit which, through a domestic tax scheme, is largely paid to the national government, it is only necessary to call attention that the profits of these concerns have been collected from the domestic purchasers and so far as the nation is concerned no profits have accrued. In our system of private enterprise certain concerns do earn a larger profit than others and we have adopted an economic program whereby such excess earnings are paid to the national government as taxes to be used to meet the normal government expenses. It is, however, difficult to see where sufficient funds to meet the postwar debt can be obtained from such a source.

The foregoing should not be taken as a suggestion that these enterprises which are fortunate enough to experience excess earnings should not be heavily taxed. This is a plan for equalising good fortune and misfortune and is in the public interest if not carried to the point where individuals receive no reward for courage and ability.

War material and services are completely destroyed, which makes possible the demand for more production, constitutes nothing more nor less than inflation and if the war with its destruction lasts for a long period our domestic economy will be affected seriously. It should not be over-locked that the apparent prosperity during the war period is fallacious and that when individual citizens appear to be presperous it is due to the fact that they are accountating wealth without taking into account their share of the war cost.

The Estional Income.

There are two ever present factors in connection with the national income - production and consumption - which are, or approximately are, in balance at all times. If there is production in excess of consumption for any one year the employment and national income will be high for that year.

This everproduction, However, in succeeding years in the absorption of the excess production and the national income will be less. If there is an underproduction then the wants and needs of society are not fully set and it can be said, as a rule, there will not be a maximum employment. Employment and the national income is in direct properties to production.

Those who have discussed the question of unemployment as being directly related to the national income have placed great emphasis upon production as the corrective. With them all unemployment is due to underproduction. To them production or those administering our operation, possess some kind of unipotence capable of providing full employment regardless of the amount of consumption or other factors of our domestic economy.

A preliminary study of this subject indicates that those with small incomes use them up currently in providing for their needs - their consumption equals their income. But as their income increases, consumption to income is on a diminishing ratio. This results in all earnings not being returned to the stream of production which tends to reduce the national income and create unemployment. It would appear that instead of a study of unemployment being made from the viewpoint of the production it is more logical to approach this subject from that of consumption and endeavor to determine a proper balance between the two, which will yield the maximum employment. Facilities are available to produce any amount which can be consumed.

Summary

Governments as a rule have no or but a modicum of wealth, and no appreciable income excepting as obtained from taxation of its citizens.

Citizens, not governments, are the real creditors and debtors in all government transactions.

High national income without inflation is desirable in providing large employment and a higher standard of living.

Any accumulation of money, land or goods from war production represents only unliquidated war debts.

The annual amount necessary to meet the debt service and provide for amortisation of a reasonable part of the war debt is so large that liquidation through normal taxation appears impossible.

The collection of taxes to meet current governmental expense has a much different effect on our domestic economy than taxes collected for payment of interest and principal on bonds which were issued in payment of some former undertaking such as war or extensive public works.

The money paid as taxes to meet current government expenses has a high velocity in returning to the stream of production but money for taxes which goes to pay the war debt will have a slow velocity. The people who receive it will need only a small portion for current needs of food, clothing and shelter; the remainder will be held as savings or otherwise which will have a material effect upon reducing the size of the immediate national income.

Our national debt will probably reach an amount of \$300 to \$400 billion by 1950.

The annual interest on \$300 billion at 25 percent amounts to \$7,500,000,000.

It took 452 years for our total national wealth to reach its present amount of \$325 to \$350 billion.

In ten years our national debt may exceed our national wealth.

To meet the debt service and amortise our national debt within

30 years would require an annual amount of \$30 billion.

The largest interest payment on the United States public debt prior to 1935 of \$1.055,423,690 was paid in 1923.

Our national dabt following World War I reached a peak of \$25,034,000,in 1919.

The largest annual reduction in our national debt was \$1,184,050,007 which occurred in 1920.

If \$10.0 billion are diverted annually from our stream of production to meet the interest and amortise the war debt the velocity of the sum will be reduced from five to one and the national income will be less by some \$40.0 or \$50.0 billion.

All funds collected for old age pensions, social security, etc.

have been used to meet general government and war expenses. The obligations
when due will have to be met through additional public taxes.

Our export business has always been small so there is little foundation for the belief that any material part of our national debt can be obtained from that source.

Reparations from the enemy cannot be espected, Losses to allies will probably never be paid.

Elstory dose not disclose any government ever having been able to pay a large war debt.

The theory that funds to meet the war debt can be obtained from the profits of a large national income of \$150 billion to \$200 billion by taxing all or nearly all commercial enterprises, appears to be fallacious. Our domestic economy with its monetary system and scheme of taxation is such that if a high national income is to be maintained, there are no physical means whereby profits can be used to meet the postwar debt. The reason the postwar debt cannot be paid from profits of a high national income is the impossibility of diverting funds from susrent production without a reduction in the immediate future national income.

Those who have proposed extensive proposition as a solution to suployment have never been able to present the details of any plan which would work. The conclusion appears fallacious.

The consumption can equal an amount to produce a national income in excess of \$100 billion, without inflation, for the decade following the end of World War II is questionable.

The liquidation of the war debt by any internal means results in a redistribution of the wealth of the nation.

All the evidence indicates that the liquidation of our postwar debt can only occur through some form of repudiation.

To refund our national debt with nonmakering certificates of indebtedness with a low rate of interest may be the best way to solve our dilemma.

American Bankers Association 719 - 15th Street N. W. Washington 5, D.C. From: Lester Gibson Released subject to delivery before
House Committee on Banking and
Currency scheduled for
Thursday, March 22, 1945

Statement of W. L. Hemingway

President Mercantile-Commerce Bank and Trust Company, St. Louis, Missouri, Past President of the American Bankers Association and member of its Executive Council, chairman of its Advisory Committee on Special Activities and member of its Committee on Treasury War Borrowing, before House Banking and Currency Committee, March 22, 1945, on H. R. 2211, The Bretten Woods Agreement Act.

Mr. Chairman and members of the Committee:

It seems to me that the only point at issue in connection with the Bretten Woods proposals is one of method. We are all aiming at the same target but some of us believe that we should go one route and others prefer another way. If it is just a matter of technicalities it would not be necessary to impose upon your time, but the differences are not more technicalities, they are fundamental, we believe. For that reason I want to present to you our views about the International Monetary Fund. In order to explain to you our understanding of the Fund I would like to use an illustration:

Let us assume that we are visiting a clearing house in one of our large cities. Clerks for various banks sit at a high desk. Other clerks walk around the desks and deliver bundles of checks. Each bank that is a member of the clearing house delivers its checks on the other banks and receives in return the checks drawn on itself. A balance struck by the manager of the clearing house readily determines the amount of debit balances against these banks having more checks against them than they have on others and a similar emount of credits to the other banks. Soon after the clearings are made, the debter banks give the clearing house checks on the Federal Reserve Bank in settlement of the debit balances. At the same time the clearing house issues its checks to the banks having credit balances. In this manner enormous quantities of checks are cleared daily with a comparatively small amount of actual payment of money. In other

words, the amount of money needed to settle the total clearings runs about 10 per

Digitized for FRASER http://fraser.stlouisfed.org/ Federal Reserve Bank of St. Louis cent. You will notice that the balances are settled in legal funds at once.

These operations are taking place all over this country daily.

There was a time, however, when this method of settling balances had to be changed to meet an emergency. That was auring the panic of 1907. At that time there were no Federal Reserve Banks and it was the practice of the banks to settle their debit balances by actual delivery of gold and currency. But in 1907 runs on the banks occurred and they paid out large amounts of money. When the withdrawals continued, money became scarce and some banks were unable to provide for the usual settlement of debit balances. Then a plan was devised by which the clearing house issued certificates, usually of large denomination, which showed that the bearer member bank had a credit of that amount at the clearing house and that the certificate was receivable by all members in settlement of balances. These certificates were then used in the place of money. They were issued in the following manner.

The bank short of money submitted certain of its notes receivable to a committee of the clearing house for examination and with it an application for credit with the clearing house for a given amount. If the committee found the notes to be acceptable collateral, and found the bank's financial condition showed it to be solvent, it would enter into a contract with the bank whereby the bank pledged its collateral in return for clearing house certificates. In this manner the banks helped one another and created a credit mechanism which tided them over the crisis.

Because the clearing house exacted a stiff rate of interest the banks paid off their obligations as rapidly as conditions improved and within a few months the confidence had been restored. Money came into circulation and the clearing house certificates were retired.

Now let us compare the proposed Bretton Woods Fund with the plan the banks followed in 1907, because conditions are very similar. In normal times the nations

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in principle like the banks settled before 1907, although of course there was no institution similar to the clearing house. But now on account of the fact that the distribution of gold has become unequal, some of the great trading nations are unable to make settlement in gold. Just as in 1907 some of the banks were unable to get the gold or currency. It is therefore necessary to provide some sort of assistance to those countries in order to revive active multilateral world trade. So the representatives of governments have devised the Fund as the method of accomplishing this.

Consider now that the manager of the clearing house has become the manager of the Fund and instead of the banks being the members of the clearing union, we find the 44 member nations. Of course they have no daily settlements, as the banks have in clearing their checks, but with the revival of world trade there will be innumerable transactions between countries and as the volume of goods flows more heavily into one country than its exports flow out, that country must sconer or later settle the difference by a payment to the exporting countries in currencies acceptable to them or gold. If it finds itself short of these currencies and gold, lat us suppose that it applies to the Fund which for the purpose of this illustration we will imagine is in operation and the applicant country a member.

Now here is one of the objections we have to the Fund. The applicant does not put up collateral but merely its own note without maturity, non-negotiable and non-interest bearing, although it really pays a low interest rate in the form of charges. The note upon demand of the Fund must be converted into the currency of the country giving the note. That would be very much like a bank in 1907 putting up its note without collateral and upon demand of the clearing house substituting its own cashier's check drawn upon itself.

It seems to those of us who have long been in the banking business that that is not the way to lend money. There is no distinction between those countries

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is the opinion of members of our committee who have studied the plan and who have talked with members of the various delegations that many of the countries will feel that they have a right to exchange their currencies for other currencies in the Fund so long as they do not violate the purposes of the Fund, which, as you know, are so broadly drawn that there could be many different interpretations in the application of them. We think that each loan should be studied and that proper security should be taken. The authors of the Fund agreement evidently had in mind the necessity for some such program because in Article 5, Section 4 there is a provision for waiver of conditions and in this section it says that the "Fund shall take into consideration a member's pledge as collateral security gold, silver, securities or other acceptable assets having a value sufficient in the opinion of the Fund to protect its interest and may require as a condition of waiver the pledge of such collateral security."

According to Dr. White's testimeny, he believes that the managers of the Fund should inquire into the credit worthiness of the applicant for use of the resources of the Fund, but it seems evident that the representatives of other countries may very properly refer to Article 5, Section 3 in which it says that "a member shall be entitled to buy the currency of members in exchange for its own currency under four conditions," none of which refer to the credit worthiness of the applicant.

This brings me to the second criticism that we have of the proposal of the Fund, namely its ambiguity. I am sure that those of you who have studied the provisions of the Fund have found it very difficult to interpret. I ask you to compare this document with Lord Keynes proposal for a clearing union, which was the first of these plans for stabilization of currencies.

In his plan, Lord Keynes expresses clearly the purposes for which the plan is drawn and the reasons back of them in a very lucid manner. I think it is easy to understand what his plan contemplates. In the proposal for the Fund, however, there are no explanations, but a very brief and general Articles of Association

prepared in a legalistic way to such an extent that if it were a domestic corporation, we could all feel sure that before it could properly function, the courts would have to determine the meaning.

We know from experience that any contract to be successfully performed must reflect a meeting of minds. It must be apparent to any one that in the present case many compromises were made and a document was drawn which might be interpreted in different ways by different persons.

The discussions that have taken place in this country and in England are evidence that there is already a difference of understanding between two of the principal members of the Fund. Certainly the men who proposed this plan are experts in the use of the English language and they could have expressed their meaning in a way that even bankers and members of Congress might understand. One wonders why these masters of English prose did not give the world another exhibition of their talent. The answer, however, is not difficult to find. Dr. White, in his testimony here and in statements that he made at the St. Louis meeting, explained that the Fund was adopted as a bridge to close the chasm that laid between public opinion in the United States and public opinion in the United Kingdom. In our country there is still a strong feeling for hard money and the gold standard. Whereas, in England there is a strong feeling against the gold standard and in favor of a managed currency. Therefore, it has been necessary for Dr. White to assure us that the Fund does not interfere with the operation of the gold standard and for Lord Keynes to emphatically inform the House of Lords that the plan is the exact opposite of the gold standard.

Unfortunately, there is no court before which this Fund agreement can be interpreted because the instrument provides that the interpretation shall be by the executive directors. In other words, the men who may differ in the interpretation must decide, or they must reach a compromise or else the Fund will end in failure. It is our belief that such will be the case and if the Fund should fail, it will not only fail to bring about harmony in our international relations, but

it will create discord and in effect be a boomerang. Again I say we are not objecting to technicalities. We are objecting to this program because we believe that it will end in failure and will bring about disharmony, and will encourage the opponents of international cooperation.

The third point to which we wish to call your attention is that of the delegation of powers. Under the plan the executive director will be appointed by the President subject to confirmation by the Senate. After confirmation, his responsibility is solely to the President. The executive director may himself appoint an alternate who in his absence may accept the full authority of the executive director. This alternate must be approved by the President, but does not require the confirmation of the Senate. Now in all banking operations with which we are familiar the executive officers are required to report to an executive committee and their actions must be authorized or confirmed. We feel that the lack of this control is a very great weakness in the plan. In an institution of this character, involving as it does matters of great national importance, it seems to us that the executive director should be required to have approval from somebody such as a committee suggested in the report of the American Bankers Association, or to Congress itself, or to some committee of the Congress. It is easy to see that the executive directors of the United States, United Kingdom and Russia can largely control the actions of this organization. We do not know what authority the other nations will give to their representatives, but if they should follow the same course that is here recommended, three individuals would have greater economic powers than have ever been conferred on anybody in the world.

We realize that there must be a delegation of power sufficient to operate efficiently and promptly, but we urge that some body of control be required which will have authority over our executive director.

In concluding my statement, I wish to call attention to what to me is the most dangerous aspect of the Fund and that is its tendency towards managed economy and that is totalitarianism. If, as Dr. White feels, the Fund should

exercise strong control over its members and its members should acquiesce in that control, then we would have in operation a body which to a degree managed the economy of each member country. As you will see on studying the plan, that any member country following the instructions of the management of the Fund will in turn have to apply very close management of exchanges in its own country. For example, take the reference to the transfer of capital funds and the agreement of one country to assist another in carrying out its transfer of capital funds. It will evidently be necessary to have almost complete control of all foreign exchanges. Everyone having foreign exchange transactions of any consequence will have to give proof satisfactory to some agent of government that it will be consistent with the government's regulations about control of capital funds. If we in this country should not attempt to control the flow of capital funds, believing it better to have free and unhampered exchanges, we are bound by the agreement to assist any other country, which, as now, will readily institute exchange controls over capital transfers. Some commentators on this believe that it may be necessary to even continue the consorship of mail in order to live up to a member's obligations to the Fund.

It is our opinion that the Fund cannot successfully operate except by the use of extreme powers which will in turn require the members to manage meticulously foreign exchange transactions. Or in other words, we see here an economic super state imposing its will on its members and the members in turn adopting or extending a program for managed currency. Now we have all been told that a benevolent despot is the best government and as long as the Fund is operated wisely there will probably be little trouble, but it requires a large degree of optimism to believe that all 44 nations will at all times be satisfied with the actions of the Fund. If they feel badly treated or dissatisfied with the operations of the Fund, they have a right to withdraw. That privilege applies, of course, to the United States, but as we are today the most favored nation in the

Digitized for FRASER of liquid resources, our withdrawal would, no doubt, endanger the Fund and http://fraser.stlouisfed.org/

and most likely would bring about international discord, the very thing that we are now attempting to prevent.

In conclusion, I would like to emphasize the sacredness of the trust which we in the United States hold. By reason of our wealth, our natural resources and our industrious people, we can make a great contribution to the well-being of the world. If we act wisely we can help others as well as ourselves. If we act foolishly we can bring harm, not only to the world, but to ourselves as well. It is for that reason that we urge you to postpone action on the International Monetary Fund and to adopt the plan for the International Bank for Reconstruction and Development, with its terms amended as will be later explained to you in detail.

American Bankers Association 719 - 15th Street, N. W. Washington 5, D. C. From Lester Gibson Released on delivery at hearing before House Committee on Banking and Currency scheduled for 10:30 a.m. Wednesday, March 21, 1945.

Statement by W. Randolph Burgess

President of the American Bankers Association Before House Banking and Currency Committee, March 21, 1945, on H. R. 2211, The Bretton Woods Agreement Act.

The American Bankers Association agrees with the purposes and with a large part of the substance of the Bretton Woods plans. The Association has been on record since 1943 in favor of an international monetary organization to help achieve these purposes. We want international cooperation and exchange stability.

The record of the Association in this respect is clear and consistent.

The Report of our Economic Policy Commission, issued September 1, 1943, said:

"Some international institution is desirable: to help nations in stabilizing their currencies; to provide a meeting place for the discussion of monetary questions; to collect information which is a necessary basis for sound decisions; and to make some arrangements for stabilization credits in cases where they are justified."

We are still in favor of these objectives as is shown in the Association's report on the Bretton Woods proposals made on February 1 to our membership.

This report was the joint product of three committees of our Association, acting with committees of two other banking organizations, the Association of Reserve City Bankers and the Bankers Association for Foreign Trade. It was approved by the governing bodies of each of these associations. The members of these committees——sixty in all——came from all sections of the United States, represented different types of institutions, and came largely from centers that have a definite interest in foreign business.

At our annual convention in September 1944 the Bretton Woods proposals

were widely discussed, the general views of our members began to crystallize, and the convention authorized the Administrative Committee of the Association to act on its behalf. The committee has done so.

Furthermore, we withheld open discussion of the matter pending the November elections in the conviction that controversy on foreign relations should, as far as possible, be kept out of the campaign.

The differences of opinion concerning the Bretton Woods proposals arise with respect to methods and NOT to objectives. We agree with the objectives, but we think that the Fund should not be created. In its place we favor the establishment of a department of the Bank to perform the stabilization functions now assigned to the Fund.

You have two sorts of questions before you: One, the question of the merits of the proposals; and the other, a question of international relations. Before we analyze the merits of the plans before you---the Fund and the Bank--- and how they fit into the present turbulent world economy, may I comment on the second question.

The negotiation of international agreements is a double task. They must be negotiated with the representatives of foreign countries; they must also be negotiated with our people at home. It is all too easy to forget the second step—to make an agreement abroad and then hope to sell it at home. But selling is not negotiation.

The proposals before you have been partially negotiated with the experts of other countries after compromises on all sides, but after little public discussion. We are told that the American people should now take them as they are—without change——otherwise new international conferences must be called——which might fail.

This is in marked contrast to the procedure with respect to the Dumbarton Oaks proposals, where a conference of technical experts was followed not only

San Francisco next month.

It should also be noted that, even with respect to the Bretton Woods conference, the American delegates were under instructions from the President which limited the scope of their deliberations as fellows:

In formulating a definite proposal for an International Monetary Fund, both you and the other delegates will be expected to adhere to the joint statement of principles of an International Monetary Fund, announced April 21, 1944. You, as head of the delegation, are authorized, however, after consultation with the other delegates to agree to modifications which, in your opinion, are essential to the effectuation of an agreement and provided that such modifications do not fundamentally alter the principles set forth in the joint statement.

You will apply the same principles in your discussions and negotiations with respect to the proposed Bank for Reconstruction and Development except that you will be governed by the principles agreed upon by the American Technical Committee.

In view of the misstatement frequently made that "44 nations" had "agreed" on the Bretton Woods plan, the precise nature of the Final Act at Bretton Woods should be noted. Lord Keynes described it as follows:

The whole of our proceedings is ad referendum to our governments who are at the present stage in no way committed to anything . . . We do not even recommend our governments to adopt the result. We merely submit it for what it is worth to the attention of the governments and the legislators concerned.

There were also specific reservations on a number of points by representatives of various countries.

Now for the first time this program comes to the American people at the policy level.

These plans are in two packages—an International Monetary Fund and an International Bank for Reconstruction and Development. The Bank has found general acceptance both here and abroad. The Fund has met opposition both here and abroad.

The changes we suggest are of such a character---all in the interest of simplification---that we believe they would not necessarily require another con-

But why should we dread another conference? Other conferences must beheld and will be useful in learning each other's point of view. One such conference is essential before long to consider trade arrangements because trade quotas, tariffs, subsidies, export bounties, bilateral arrangements could completely defeat any program for monetary stabilization. Trade policies and monetary policies should logically be considered together.

The reasons why we are proposing a simplification of the Bretton Woods plan will be developed more fully by my associates, but I should like to review briefly today some of the major reasons.

- 1. Size and nature of need. Much of the testimony which has been offered here seems to me to be based on a misconception of the financial position of the world today. It has been said that much of the world is impoverished and devestated and that we face the task of putting it together again. The devastated areas, in fact, are limited to parts of a few countries, and many of the countries of the world are affluent. They have benefited from our huge war expenditures. We think of Uncle Sam as rich as Greesus but lately he has been growing powers and their countries richer. While our gold reserves have declined to a point where we must lower our reserve percentage, other countries have been increasing theirs. Nations outside the United States now hold over 20 billions of gold and dellars. This has risen by 7 billion dellars since our government's experts began discussing international achievary plans three years ago. Other countries have gained more gold and dellars than the entire United States' quota in both proposed institutions. The pressing need for loans is limited to a few areas and a few countries.
- 2. Assurance of soundness. Another reason for eliminating the Fund and concentrating its necessary powers in the Bank is that the Bank's loans are made on sound principles. While various safeguards have been inserted in the Fund plan it still remains true that members of the Fund have a right to borrow under

certain conditions which are not difficult to fulfill. Long experience has



shown that poor leans are as bad for the borrower as for the lender.

The lending policy of the Bank is much more carefully protected, both in the method of making loans and in the fact that the country whose money is used has a veto power.

The concentration of the lending power in the Bank would assure wiser and better lending policies. It would enable us to do what has to be done for less money. The 10 billion dollars capital of the Bank is more than adequate for any probable needs for some years, but it could be supplemented later if circumstances justified such action.

3. Protection of United States principles and interests. The United States has certain definite national points of view and interests. There is no provision in the Fund to avoid the use of our dellars by countries which are following policies directly contrary to ours or for purposes to which we are opposed. The Bank, however, which gives a country veto power over the use of its money, provides protection to the lender.

In addition to this defect in the Fund, there is the provision for the treatment of scarce currencies. The currency most likely to be scarce is the American dollar; on that point there is no dispute. If dollars become scarce, what will happen? It will inevitably be charged that the United States is to blame and we shall once again be branded "Uncle Shylock" unless we put up large additional sums.

4. Economic warfare. The proponents of Bretton Woods assert that one of its twin objectives is an end to economic warfare. Yet the Agreement attacks only the monetary weapons of that warfare—and only partially attacks these-namely, currency depreciation and exchange controls. As to the former the Agreement actually stipulates that a 10 per cent depreciation is permissible without the consent of the Fund, and the Fund must allow further depreciation if there is "fundamental disequilibrium." That is not hard to prove. As to

Federal Reserve Bank of St. Louis

But no other of the powerful weapons of economic warfare is forbidden. Tariffs can be raised or lowered. Quotas, embargoes, subsidies on production, export bounties, preferences, and bilateral agreements (cutside the Fund) can ALL be used.

The Fund provides only a start in dealing with economic warfare---a start which we believe could be made more effectively through the Bank.

5. Why one institution? We believe that the objectives of Bretton Woods could be carried out best if there were but one international financial organization instead of two. We think the one organization could carry out the objectives more efficiently, in a more orderly way, and more economically than could two.

Since both would be making loans and promoting international trade, confusion would be almost inevitable. Dollars are what most nations will want. As the plan is set up it is easier and cheaper to get dollars out of the Fund than out of the Bank. Nations have an almost automatic call upon dollars in the Fund, while in the Bank they must prove that they have good loans. In the last analysis America has a right to veto a dollar loan by the Bank just as other nations have a veto on loans in their currencies.

We believe the Fund should be a department of the Bank. We believe the same board of directors ought to have charge of the policy of both lending operations. Why? Because otherwise a nation may be borrowing so much short-term money from the Fund that it will endanger the soundness of its long-term obligations to the Bank. An ordinary bank in this country makes short-term loans and long-term mortgage loans to the same people or buys their bonds. It knows the current financial position of its borrowers and also knows what obligations its borrowers have to meet in the years shead.

Rules regarding international exchange restrictions, parities, and other such questions can be worked out through the stabilization department of the



Bank more effectively than if such questions were relegated to an institution which had no responsibility with respect to long-term loans. Some stabilization programs will call for long-term loans.

Furthermore, we believe that the objectives set forth at Bretton Woods can be accomplished by about one-half of the commitment of the present proposals. Stabilization loans need not involve huge sums of money if well made. A country stabilizes itself by pursuing proper fiscal, business, and trade policies. Going into debt through borrowing from foreigners may help for a time but a country cannot hope for permanent stabilization by borrowing alone. It must produce and save and export to get back to stability. Assuming a country wants to stabilize, loans can be helpful but they are not the primary method to attain stabilization.

Some say "What difference does it make what it costs America? We are a wealthy nation." May I call your attention to the fact that a couple of years ago all of us believed that we could feed ourselves and the world, if necessary, during this war, but in recent weeks we have been shocked by the realization that even we can run short of food—a thing we thought we had in great abundance. The President has set up a committee to control our exports, and has just asked us to tighten our belts.

We can't go on lending dollars indefinitely. We have lost more than two billions of our gold during the war, while our liabilities have vastly increased. We want to do all we can within our means to help the world toward recovery. We believe we can attain the objectives of Bretton Woods at half the cost. By doing so we help to maintain the stability and integrity of the American dollar, which is now the financial anchor for the world.

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