

BRITISH AND AMERICAN PLANS FOR INTERNATIONAL CURRENCY STABILIZATION

by

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## BRITISH AND AMERICAN PLANS FOR INTERNATIONAL CURRENCY STABILIZATION

The British plan of Lord Keynes for an International Clearing Union and the United States Treasury plan, known as the White plan, for an International Stabilization Fund, both of which were announced recently, are encouraging signs toward greater international cooperation in monetary matters. They are evidences that exchange stability is receiving primary attention among the post-war problems. Both are tentative proposals offered by technical experts as a basis for study and discussion.

### Credit Agencies

Each plan provides a mechanism for granting foreign credits to member countries and for promoting conditions under which payments between countries arising out of trade and other transactions can be brought into balance and maintained in a state of equilibrium.

Each plan provides for a new international monetary unit which would be used for tying the various currencies to gold and to each other. The new unit would be used for accounting purposes but not for circulation. In the case of the Keynes plan, the unit of account is called "bancor" and in the case of the White plan, it is called "unitas." Each would have a definite relationship with gold and with the currency of each member state. Therefore each plan involves a definite relationship between the currencies of the various countries and gold.

Both plans contemplate the use of gold in settling international balances, and both provide an unlimited market for gold at the established price. Member countries may buy and sell gold freely, but the White plan seems to place the greater emphasis on the importance of gold as an international standard of value. The gold value of the unitas would be fixed permanently but that of the bancor could be changed. Furthermore, the Keynes plan does not favor full two-way convertibility, and suggests that member countries might permit the export of gold only under license.

The adherence of the White plan to gold, and its objective of stabilizing currencies in relation to gold, implies the abandonment in this country of the idea of manipulating United States exchange rates and the price of gold for the purpose of altering our commodity prices.

The Keynes plan contemplates that some general agreement will be reached between the member countries regarding the relative values of the different currencies before the plan goes into effect, but the White plan provides that the Board of Directors of the Fund will fix the rates. No doubt an effort will be made to establish values which will approach equilibrium as closely as possible, although some changes would undoubtedly have to be made as time goes on. Furthermore, the method of determining these values initially would presumably be the same under each plan, and the rates established would probably be the same whichever plan is adopted.

In each plan the international agency would deal only with the central banks or treasuries of the member countries, and, according to their sponsors, would not interfere with the existing agencies or methods of financing international transactions. Central banks or treasuries would keep accounts with the International Clearing Union or Stabilization Fund, in terms of bancor or unitas, as the case may be, and would use the central agency for dealing with exchange balances between countries.

The process of granting credits differs somewhat between the two plans. The Clearing Union of the Keynes plan, having no funds to begin with, would provide overdraft facilities to member countries. Country A, for example, finding itself building up a debit balance with country B, would decide to transfer this debit balance to the Clearing Union; that is, the Union would debit A and credit B. A country having a favorable balance of payments with the rest of the world as a whole would find itself building up a credit account with the Clearing Union in terms of bancor. In other words, the creditor countries as a group would, in effect, be extending credits to the debtor countries as a group.

The Stabilization Fund of the White plan, having assets to begin with, would exchange one currency for another or buy one currency and sell another. The Fund would also have means of increasing its supply of any currency, i.e., by borrowing or by selling some of its assets. In the case of both plans measures would be necessary to limit the amount of credit extended to any country,

#### Similar Objectives

The objectives of the two plans are similar. They would attempt to stabilize foreign exchange rates and promote conditions under which stability can be maintained. They would seek to reduce foreign exchange controls that interfere with world trade, and help to eliminate bilateral exchange clearings, multiple currency devices, blocked balances, and discriminating foreign exchange practices. In general the aim would be to promote and maintain equilibrium in international transactions.

Each plan would seek to accomplish general stabilization as soon as possible in order to avoid the monetary chaos that might come from waiting. After the last war efforts to stabilize were sporadic and uncoordinated; some countries undervalued and some overvalued. Often when one country decided to change the value of its currency others had to follow suit. One country's difficulties led to the imposition of various exchange controls and trade restrictions. These in turn sometimes led to retaliatory measures by other countries, and variations in exchange rates were used as measures of economic warfare.

These monetary difficulties were in part the result of a lack of general economic cooperation between the countries of the world. Tariff barriers and other trade restrictions added to the monetary troubles, and monetary troubles in turn increased trade difficulties. The establishment of sound international trade relations was retarded. Difficulties were obscured for a period by the flow of capital, much of it short-term, from creditor to debtor nations, but the borrowing nations were building up economies that could continue only on the basis of

a constant inflow of new loans. This only increased the ultimate strain on the international monetary organization.

International economic relations may be even more difficult to adjust after the present war, and the problem which concerns governments today is how to prevent the same kind of chaos that prevailed in the world's monetary and trade relationships during much of the 1920's and 1930's. Currency stabilization is an international problem, and the sponsors of these plans believe that the coordination of efforts under some international agency would probably have a better chance of success than any scheme of bilateral arrangements or unilateral action.

At the present time the reserves of gold and foreign exchange are very unevenly distributed. There is a genuine need to provide all countries with some reserves in order to tide them over the immediate post-war period and give them time to work out their problems. The sponsors of these plans believe that the proposed institutions would provide member countries with the essential reserves.

The proposed institutions are not designed to finance relief and reconstruction. A stabilization agency would quickly freeze up if it assumed those obligations, but it could not succeed unless these other financial needs were met. The sponsors of these plans fully recognize the need for other agencies to provide funds for relief and capital for post-war reconstruction and development. Stabilization plans are only a part of the general program for post-war international rehabilitation.

There are substantial differences in details between the two plans, but these differences do not seem to be insuperable if some such over-all mechanism should be found desirable. They will probably be modified materially on the basis of suggestions from other countries.

#### Membership and Additions to Membership

White Plan -- The White plan proposes to establish an International Stabilization Fund in which all the United Nations and those nations associated

Keynes Plan -- All the United Nations will be invited to become original members of the International Clearing Union. Other states may be invited to join subsequently. If ex-enemy states are invited to join, special conditions may be applied to them.

Comment -- It will be partly a political question whether we should help to rehabilitate the enemy countries and aid in stabilizing their exchanges. Some such aid may be required if we are to attain the desired economic order in the world. The greatest need for stabilization aid will probably be felt by the ex-enemy countries, by the eastern and southeastern European countries, and perhaps by China. South-American countries as well as such European countries as France, Switzerland, Sweden, Holland and Belgium, may have enough gold and foreign exchange to tide them over the initial stabilization period without large credits, although some of them may need relief aid and long-term reconstruction loans. England will need some kind of special aid in dealing with the blocked balances in that country.

#### Quotas of Member Countries

One important difference between the two plans is the determination of the quotas for member countries, i.e., the extent of their participation. Quotas are used not only as a basis for determining rights to credit facilities by the various countries, but also as a measure of their voting power.

White Plan -- The White plan sets up a Fund of at least \$5 billion consisting of gold, currencies of member countries, and securities of member governments. Each country would subscribe a specific quota to this Fund, the quotas to be determined by some agreed-upon formula which takes into consideration various factors, including holdings of gold and foreign exchanges, magnitude of fluctuations in balances of international payments, and national income. The United States quota is estimated at about \$2 billion. Each country would provide 50 per cent of its quota to start with, but further contributions might be required by the Board of Directors by a four-fifths vote. Any changes in quotas would also require a four-fifths vote.

Keynes Plan -- The Keynes plan provides no fund or stated assets at the time of organization. It merely sets up a Clearing Union which would establish overdraft facilities for member countries. The Union would settle balances between countries simply by debiting one and crediting the other. The extent of these transactions would be limited by the quotas assigned to each member country. The initial quotas might be fixed by references to the sum of each country's exports and imports on the average of (say) the three pre-war years, and might be (say) 75 per cent of this amount. It is a matter for discussion whether the formula should take into account other factors. Quotas may be revised annually.

Comment -- The sum of the quotas under the White plan would be fixed at a minimum of \$5 billion, with the United States quota equal to 40 per cent of the total. If all but ex-enemy countries should join the Clearing Union, however, the sum of the quotas under the Keynes plan would aggregate about \$29 billion on the basis of 1936-1938 trade figures. The United Kingdom would have about 16 per cent of the total, the British Empire about 35 per cent, and the United States about 14 per cent. If fewer countries should join, the total of all quotas would be less, and each member country would have a larger proportion of the total.

Under the White plan all countries outside the United States would have the right to borrow from the Fund less than \$3 billion of additional credits, i.e., credits in excess of their gold contributions, although that amount could be exceeded by permission of the Board of Directors on deposit of special reserves, provided the currencies wanted could be supplied. Under the Keynes plan, however, foreign countries could conceivably accumulate debits of nearly \$25 billion. That is a theoretical limit based on the assumption that the United States would be the only creditor country and all others would be debtor countries. That would not occur, of course, but it might be possible for debit balances to reach half that figure, or even more, if creditor countries should continue to supply the funds.

In the case of the White plan a country's quota represents the amount which that country is obligated to bear in financing the plan. If the United States' quota is \$2 billion, for example, that is the extent to which the United States is obligated to contribute. However, the United States could contribute more by lending additional dollars to the fund or by making other special arrangements to supply dollars. In the Keynes plan, on the other hand, a country's share in the financing would depend on the size of the credit balance it accumulates, which could conceivably equal the sum of the debit balances of all other member countries.

It looks as though either the White plan is not providing sufficient credits or the Keynes plan is providing for excessive credits. The management has broad powers in either plan, however, and the matter of excess or insufficiency of credits granted might depend on how they are administered. It is obvious that these formulas for fixing quotas will have to be examined very critically in the light of all the factors involved, and probably some compromise worked out in order to produce the most equitable arrangement.

#### Management and Control

White Plan -- The White plan provides that each country shall have a representative on the Board of Directors, which shall meet annually. The Board would appoint a Managing Director and also an Executive Committee of not less than eleven members which would be continuously available at the head office of the Fund to exercise the authority delegated by the Board. This plan suggests that each country might have 100 votes plus one vote for each 100,000 units (\$1 million) of its quota, but no country may cast more than one-fourth of the total votes. In general the majority votes would govern except on certain specified important questions which would require a four-fifths vote.

Keynes Plan --- The Keynes plan provides for a Governing Board not to exceed (say) twelve to fifteen members. The states with the larger quotas would have individual representation on the Board but the states with the smaller quotas might be



arranged into convenient political or geographical groups, each group appointing a representative. Member states not individually represented on the Board might appoint permanent delegates to the Union to maintain contacts and act as liaison. Each representative on the Governing Board would have votes in proportion to the quota of the state or states appointing him, except on a proposal to increase a particular quota in which case there would be some modification of the voting power.

Comment -- Although under the White plan the United States would contribute about 40 per cent of the resources of the Fund, this country's voting power would probably be in the neighborhood of 20 per cent of the total, assuming a membership of fifty countries. The United States, however, might have sufficient votes to veto action on any important matter requiring a four-fifths vote. With a smaller membership the United States would have a larger proportion of the total vote.

It has been shown above that under the Keynes formula for quotas, assuming all but ex-enemy countries would join, the United Kingdom would have 16 per cent of the votes, the British Empire 35 per cent, and the United States 14 per cent.

The voice that each country will have in the management will probably be one of the difficult points of agreement. There is no doubt but that the United States, as the largest creditor country, will make the greatest contribution, whatever plan may be adopted, and, therefore, may feel that it should have a substantial voice in the management. On the other hand, the smaller countries will be exceptionally sensitive to anything that smacks of domination by any one power, or any two powers, for that matter. Many of the small countries will make genuine contributions to the success of the scheme and they will feel that it should be a genuinely cooperative effort. Political considerations will doubtless play a part in the decisions regarding control, especially where the plan must be approved by legislative bodies.

#### General Powers

White Plan -- The White plan provides that the International Stabilization

1. To buy, sell, and hold gold, currencies, bills of exchange, and government securities of member countries; to accept deposits and earmark gold; to issue its own obligations and discount or offer them for sale in member countries; and to act as a clearing house for the settlement of international movements of balances, bills of exchange and gold.

2. To fix the value of the currency of each member country in terms of gold or unitas; to fix the rates at which it will buy and sell one member's currency for another, and the rates in local currencies at which it will buy and sell gold. (Exercise of this power requires a four-fifths vote.)

3. To sell to any member country the currency of any member country which the Fund holds, provided that the foreign exchange is required to meet an adverse balance of payments on current account with the country whose currency is being demanded. (There are definite limitations on the Fund's holdings of the currency of any member country, but this will be covered in a later section.) In exceptional circumstances and on a four-fifths vote the Fund may also sell foreign exchange to a member country to facilitate the transfer of capital or the repayment or adjustment of foreign debts.

4. To buy and sell currencies of non-member countries; to borrow the currency of any member country; to sell member country obligations owned by the Fund, provided the representative of the country in which the securities are to be sold approves; to obtain rediscounts or advances from central banks; to invest its currency holdings in government securities and prime commercial paper; to lend to any member country its local currency, within limitations; and to levy upon member countries a pro rata share of the expenses.

Keynes Plan -- The Keynes plan provides that the Clearing Union shall have power to set up the machinery for extending credits and clearing balances, to fix the value of bancor in terms of gold, to change the value of individual currencies in terms of bancor under certain conditions, to reduce or raise quotas, to reduce the quotas of all members in the same proportion if deemed necessary, to recommend and discuss with member states measures for correcting continuous debit or credit balances, and to ask member states for relevant statistical or other information.

Comment -- The Keynes plan provides for a lending mechanism without other broad banking powers, and, on the surface, seems the simpler plan, even though it provides more extensive credit facilities. The White plan provides for a Stabilization Fund with a large capital and with powers to engage in a wide variety of international

banking operations. It could accept deposits, lend and borrow money, and deal in securities. The fact that it could borrow money and issue its own obligations might bring the Fund's activities nearer the scope of the Keynes Union. In spite of its limited size some opposition seems to have arisen to the Stabilization Fund because of its extensive activities. These general banking powers which the Fund would have, however, do not seem to be any more comprehensive than those now possessed by the Bank for International Settlements. The purpose of these powers is to enable the Fund to cooperate effectively with the monetary authorities of the member countries.

It has been suggested that an institution which can engage in these broad banking activities might compete with existing commercial banks and interfere with the regular channels of international trade and international banking. The plan provides, however, that the Fund shall deal only with or through treasuries and central banks. It does not appear, therefore, that the Fund could engage in general banking activities except with the consent of the member countries involved, but would use these powers to cooperate with the local monetary authorities. Mr. Morgenthau says of the Stabilization Fund, "It would not compete with private banks or existing agencies. Its operations would be maintained only to supplement the efforts made by each member government to maintain monetary stability. The established channels of international trade and international banking would be retained in full for all international transactions."

Some interference with existing agencies and practices might seem to be implied in the provision that each member country shall agree to offer additional acquisitions of gold and foreign exchange to the Fund and to discourage the unnecessary accumulation of foreign balances by its nationals. The purpose of that provision, however, is to safeguard the Fund against the misuse of its resources by a member country. With that provision a country could not continue to buy foreign exchange from the Fund while at the same time accumulating excessive holdings of gold and foreign exchange. No country would be under obligation to sell gold and foreign

exchange to the Fund except for its local currency or foreign exchange acceptable to it. A creditor country, of whose currency the Fund has only a small or moderate amount, would not sell additional accumulations of gold and foreign exchange to the Fund because the Fund would not have the local currency to pay for such purchases.

The Fund is also given power to deal in securities and to make loans, but it is doubtful whether these operations would compete with existing banking institutions. The purpose of these powers seems to be to permit countries without adequate money markets and with rigid monetary systems to offset any expansionist or contractionist effect that their dealings with the Fund might otherwise have. Such activities can be undertaken only with the approval of the member country.

Mr. Keynes says of his plan, "No transaction in bancor will take place except when a member state or a central bank is exercising the right to pay in it ... thus the fabric of international banking organization, built up by long experience to satisfy practical needs, would be left as undisturbed as possible."

#### Problem of Debit Balances

White Plan — The Fund's holdings of the currency of any member country shall not exceed that country's quota during the first year of operation, 150 per cent of the quota during the first two years or 200 per cent thereafter, except that on a four-fifths vote of the Board these limitations may be exceeded provided at least one of the following conditions is met:

- (a) The country agrees to adopt and carry out measures recommended by the Fund to correct the disequilibrium in the country's balance of payments, or
- (b) It is believed that the excess accumulation will be temporary.

The right of a member country to purchase foreign exchanges from the Fund with its local currency for the purpose of settling an adverse balance of payments on current account is recognized only to the extent of its quota. When the Fund's holdings of any local currency exceed the quota, that country must deposit a special

reserve with the Fund. When a country is exhausting its quota more rapidly than seems warranted, the Board may impose such conditions on additional sales of foreign exchange to that country as it deems in the general interest of the Fund. A country may also change the value of its currency with the approval of the Fund. Furthermore, a charge at the rate of 1 per cent per annum payable in gold shall be levied against any member country on the amount of its currency held by the Fund in excess of the quota of that country. However, a country whose debit balance exceeds the quota may repurchase the excess by paying to the Fund gold or acceptable foreign exchange. (Presumably the above borrowing limitations are expressed in terms of the full quotas as determined by the formula and not by the amounts paid in.)

Keynes Plan -- A member state may not increase its debit balance by more than a quarter of its quota within a year without permission of the Governing Board. If its debit balance has exceeded one-fourth of its quota on the average of at least two years, it may reduce the value of its currency in terms of bancor provided the reduction shall not exceed 5 per cent without the consent of the Governing Board.

The Governing Board may require a member state having a debit balance equal to half its quota to deposit suitable collateral. As a condition of allowing a member state to increase its debit balance to more than half its quota, the Board may require all or any of the following measures:

- (a) A reduction in the value of the member's currency,
- (b) The control of outward capital transactions,
- (c) The surrender of a suitable proportion of any separate gold or other liquid reserve in reduction of its debit balance.

Furthermore, the Governing Board may recommend to the member state any internal measures affecting its domestic economy which may appear appropriate to restore the equilibrium of its international balance.

If a member state's debit balance has exceeded three-fourths of its quota on the average of at least a year and is excessive in the opinion of the Governing Board or is increasing at an excessive rate, it may be asked to take measures to improve its position. In the event of its failing to reduce its debit balance within two years, the Board may declare it in default and no longer entitled to draw against its account except with permission.

A member state shall pay 1 per cent per annum on the amount of its average balance which is in excess of one-fourth of its quota, whether it is a debit or a credit balance; and a further charge of 1 per cent on its average balance in excess of one-half of its quota, whether credit or debit. Thus only a country which keeps in a state of international balance on the average of a year will escape this contribution.

Comment -- This matter of dealing with debit balances would be the major problem of any international agency set up to stabilize exchanges. It is here that the mechanism would succeed or break down. Both institutions are post-war lending agencies designed to give debtor countries time to make their adjustments and bring their payments into balance. Presumably the efforts of the stabilization agency would be supplemented by programs for relief, reconstruction loans and commodity price stabilization. Political stability is a prerequisite to exchange stability, however, and there are many basic causes of disequilibrium which may not always be cured by loans and credits.

One striking feature of both plans is that no tests or standards are set up for debtor countries in making initial credits. In other words the borrower need not show his balance sheet. It seems that any country could join and secure large credits before taking any steps towards putting its own house in order. This is a matter of detail which could be easily remedied, however.

The White plan is not very specific as to what measures the Board of Directors may take to induce the correction of excessive debit balances. It simply

says that certain limits may be exceeded if the country concerned agrees to adopt and carry out measures recommended by the Fund to correct disequilibrium in the balance of payments. The Keynes plan, however, says that the Board may require a reduction in the value of a member's currency or the control of capital exports or the surrender of gold and other reserves. A central board with a capable technical staff will presumably be in a position to diagnose the exchange troubles of any debtor country and to recommend measures of correction.

Whether the causes of the difficulties can be remedied within reasonable time, however, depends on how deep-seated they may be or how much effort the member country may exert in that direction. A lack of balance is not always a temporary matter. The trend of payments may run consistently in one direction, and the granting of credits may simply postpone the necessity for taking corrective measures. The member countries make only general commitments to take corrective measures, and if the need calls for strenuous action they may hesitate and delay. The size of the debit balances would be the test of the success of the plan, and would determine whether the credits extended are really capital loans. The Fund or Union might become frozen and bog down unless the creditor countries were willing to extend credits almost indefinitely.

One possible result of operations might be that the better credit risk countries would continue to settle their balances in the usual way, i.e., outside the international clearing mechanism, because they have the means of payment. The countries which represent the poorest credit risks, those that have not put their internal affairs in order or balanced their payments, would need and use the mechanism most. If affairs should take that turn, the influence of the Fund or Union in international affairs would be very limited, and cooperation by creditor countries might be greatly restricted. The issue might ultimately come down to the alternative of either giving the central agency broad control over all international transactions or having it pushed aside into a very limited sphere of influence.

Control Over Short-Term Capital Movements

White Plan -- Member countries agree to cooperate in regulating capital movements in various ways, including (a) the refusal to accept deposits, securities or investments from any member country imposing restrictions on capital exports except on permission of that country, (b) the furnishing of full information on all property in the form of deposits, securities and investments of the nationals of a country restricting capital exports.

Keynes Plan -- As a condition of allowing a member state to increase its debit balance to more than half its quota, the Board may require, among other measures, the control of outward capital transactions.

Control of capital movements, both inward and outward, should be a permanent feature of the post-war system. But since such control cannot be regarded as essential to the operation of the Clearing Union, the method and degree of such control should be left to the decision of each member state. It would be of great advantage if the United States and other members of the Union would adopt machinery similar to that of the British Exchange Control.

Comment -- While both plans contemplate control over international movements of capital, this control would be exercised by the member countries themselves with the approval of the Stabilization Fund or Clearing Union. This applies largely, of course, to the flight of funds for political reasons or to evade domestic taxation, or to any movements of funds out of debtor countries which lack the means to finance them. Medium- and long-term loans by creditor countries which will help to maintain equilibrium and develop the world's resources will be encouraged, presumably by setting up some international investment organization.

The question arises here as to whether capital movements can be regulated without control of practically all exchange transactions. There are so many ways by which capital may be transferred that it is sometimes exceedingly difficult to discriminate between current account and capital account. What may seem to be simple



one country and sold in another, thereby effecting a transfer of capital. The nationals of a country, which had built up a heavy debit balance with the central stabilization agency, might ship goods to the United States and invest the proceeds here instead of reducing the debit balance by turning over the dollars to the central agency. If exchange stabilization depends upon control of capital movements, might not that require the policing of all transactions by the international authority? Would these plans perpetuate exchange controls instead of removing them? More light on the question of capital transfers is needed.

Mr. Keynes says, "There is no country which can, in future, safely allow the flight of funds for political reasons or to evade domestic taxation or in anticipation of the owner turning refugee. Equally, there is no country that can safely receive fugitive funds, which constitute an unwanted import of capital, yet cannot safely be used for fixed investment."

This raises the question as to whether any such over-all stabilization scheme could work as long as we have refugees and flights of capital for political reasons. Is it not essential to have political stability before exchange stability can be achieved? If so, the immediate post-war period may offer a very unfavorable setting for the inauguration of either of these plans.

#### Problem of Credit Balances

White Plan -- When the Fund's holdings of any particular currency drop below 15 per cent of the quota of that country, after the gold and obligations contributed by that country have been used to purchase additional currency, the Fund will render to the country a report embodying an analysis of the causes of the depletion of its holdings of that currency, a forecast of the prospective balance of payments, and recommendations for increasing the Fund's holdings of that currency. This report should be sent to all member countries and, if deemed desirable, made public.

When it becomes evident to the Board of Directors that its holdings of a particular currency will not be sufficient to meet all demands, steps will be taken to see that the distribution is equitable. Furthermore, the Fund will make every effort to increase the supply of the scarce currency.

The Fund has various ways of increasing its holdings of member country currencies. Perhaps the most important method is the power to borrow from central banks. It may also issue its own obligations and discount or offer them for sale in member countries. Also "the Fund may make special arrangements with any member country for the purpose of providing an emergency supply under appropriate conditions which are acceptable to both the Fund and the member country." Thus there is practically no limit to the amount of credit that the United States or other creditor countries could extend to keep the plan operating.

Keynes Plan -- A member state whose credit balance has exceeded half its quota on the average of at least a year shall discuss with the Governing Board (but shall retain the ultimate decision in its own hands) what measures would be appropriate to restore the equilibrium of its international balances, including:

- (a) Measures for the expansion of domestic credit and domestic demand,
- (b) The appreciation of its local currency in terms of bancor, or, alternatively, the encouragement of an increase in money rates of earnings,
- (c) The reduction of tariffs and other discouragements against imports, and
- (d) International development loans.

A member state may obtain a credit balance in bancor by depositing gold with the Clearing Union, but no one is entitled to demand gold from the Union. The Governing Board, however, may at its discretion distribute any gold in its possession to members possessing credit balances in excess of a specified proportion of their quotas.

Comment -- Both plans recognize the responsibility of creditor countries to help correct the disequilibrium in the exchanges. In case of credit balances, of course, no rigid maxima are proposed, nor do they deprive any member state of any of the facilities which it now possesses for receiving payment for its exports. A creditor country may continue to employ the proceeds of its exports to buy goods or investments abroad, to buy gold, or to make temporary advances. Member state creditor countries may be asked to adopt credit policies or trade and tariff policies which will help to cure the disequilibrium, but there is no force to compel the acceptance of such suggestions. The penalty would be the continued accumulation of credit balances. We have noted in a previous section how much greater a country's financial obligation might be under the Keynes plan than under the White plan (p. 7).

The provision in the Keynes plan that the lending countries should pay interest on their credit balances above a certain amount seems somewhat unusual, but the purpose is to induce creditor countries to take the steps necessary to reduce their credit balances. In other words, excessive credit balances are looked upon just as critically as excessive debit balances and the creditor as well as the debtor is under obligation to help maintain equilibrium in international payments.

Probably the United States will have a big favorable trade balance for several years after the war. The rest of the world will need our goods, and their problem will be to get dollars to pay for them. Not only would the United States be the principal supplier of credits, but to make either plan successful we would also have to supplement our credits with long-term loans.

In addition we will probably continue to draw gold into the United States. Many countries may use gold to buy dollars without going through the clearing agency, since both plans contemplate the free use of gold in settling international balances. The Stabilization Fund might actually accelerate the flow of gold to the United States because much of the gold deposited with the Fund by the various countries might be used to buy dollars.

Effect on Money Markets

Keynes seems to place much more emphasis on the management of money markets as a means of aiding stabilization than White does. To remedy excessive credit balances, for example, he advocates measures of expansion of domestic credit and domestic demand and also steps to appreciate local currencies or increase money rates of earnings. In countries developing excessive debit balances, he would reduce the value of a member's currency as a deflationary measure. In other words, Keynes would impose a large degree of monetary management, although in case of the creditor countries the ultimate decision would be left to the country itself.

The operation of either plan, without monetary management, could affect money markets very much as the importation and exportation of gold did under the old gold standard; that is, it could be deflationary in debtor countries and inflationary in creditor countries. Whether it would actually work out that way, of course, would depend upon whether the debtor and creditor countries undertake to offset the effects of the operations of the plan on their money markets. If the creditor countries permit the inflationary effects and the debtor countries offset the deflationary effects, the general effect on the world would be inflationary.

In the debtor country, the accumulation of local currency in the central bank would tend to reduce the reserves of the commercial banks and have a contractionist influence. This, according to standard monetary theory, would tend to reduce prices, encourage exports and discourage imports. If the debtor country, however, should choose to offset this influence by central bank open-market operations or other monetary activities, it could avoid contractionist pressure. This, of course, might increase the time necessary to bring about conditions of stability,

In the case of the creditor country, the purchase of foreign exchange from the market by the central bank would have the effect of increasing bank reserves, thereby producing an inflationary tendency; that is, prices might tend to rise, which would encourage imports and discourage exports. Here again,

a country could offset this influence just as it can offset the effects of gold imports.

Under the Keynes plan the United States would be financing debtor countries with Federal Reserve Bank credit to the full extent of our credit balance, and the possible extent of that credit balance as shown in a previous section indicates what a burden it might become. The banks and dealers in foreign exchange would sell their surplus holdings of foreign exchange to the Federal and the Federal would in turn receive a credit balance in bancor. To the extent of our credit balance, therefore, it would be just as inflationary as if we imported gold for the same amount, because it would increase member bank reserves. The effects could be offset, of course, if the Federal Reserve had sufficient securities to sell in the open-market or sufficient powers to raise reserve requirements. Regardless of the ability of the Federal to offset the inflationary effects, however, the suggestion for financing the balance of payments through central bank credit should receive critical examination to determine its various implications. Would the assets behind our own Federal Reserve notes and behind member bank reserves consist in part of the deficits of debtor countries?

The White plan would have a similar inflationary effect to the extent that the Stabilization Fund should borrow from the Federal Reserve Banks, which might be substantial, since that apparently would be the principal means for the Fund to acquire additional dollars after the original contribution becomes exhausted.

It is entirely probable that many countries would continue to manage their money markets with a view to domestic policies rather than for the purpose of curing debit or credit balances, especially if there should be a conflict between domestic policy and international policy. The United States, for example, will probably be committed to stable interest rates for many years because of the conditions created by war financing. It is not likely, therefore, that this country would permit the operation of an international stabilization mechanism to create

either an expansion or a contraction of credit sufficient to change our interest rates materially.

Both plans, no doubt, would tend to expand the volume of world trade because of the credits set up, but whether this development would be entirely sound or have permanent benefits needs careful consideration.

#### Limitations on Actions of Member Countries

White Plan -- In addition to agreements by the member countries to cooperate in carrying out the plan, to adopt appropriate legislation, to furnish information to the fund, and to give consideration to the views and recommendations of the Fund, there are some specific limitations imposed upon the actions of each country, such as agreement:

1. That the value of the currency of each member country shall be fixed by the Fund in terms of gold or units, and that exchange rates may not be altered, except with the consent of the Fund,
2. To abandon as soon as conditions permit all restrictions and controls over foreign exchange transactions (other than those involving capital transfers) and not to impose additional restrictions without the consent of the Fund,
3. Not to enter upon any new bilateral foreign exchange clearing arrangements, nor to engage in multiple currency practices, except with the approval of the Fund.

Keynes Plan -- While the limitations imposed upon member countries by the Keynes plan are not always stated as specifically as in the White plan, they are clearly implied and quite similar. For example, a member state may not alter the value of its currency in terms of bancor without the permission of the Governing Board, except under certain stated conditions, and may not purchase or acquire gold at a price in excess of the price fixed by the Governing Board. Member states also agree to refrain from certain restrictive measures, such as import regulations and higher import duties, except under certain conditions.

Comment -- Adherence to either plan calls for some suspension of sovereign rights; for example, the right to alter exchange rates, or the right to

impose new exchange restrictions without the consent of the central agency, or the right to follow credit and financial policies disadvantageous to other countries. The organizations proposed, however, are not endowed with irrevocable powers because these powers can always be changed by vote of the member nations. Furthermore, a member country always has the option of withdrawing, although there might be some adverse effects on the country withdrawing, especially a smaller country. The suspension of some sovereign powers to achieve desired ends cannot be viewed as a very serious objection. Any international organization or association involves the giving up or suspension of some freedom of action by the individual countries.

Giving the Stabilization Fund power to fix the value of the dollar in terms of gold, however, will hardly be accepted by Americans as either reasonable or necessary. This power was specifically conferred upon Congress by the Constitution and could not be surrendered without a constitutional amendment. As the White plan is drawn, the United States, through its voting power, might be able to prevent the fixing of any rate which it disapproves, but that would not alter the fact that the power had been delegated to an international body, or that the United States representative might not vote the views of Congress. Furthermore, the smaller nations would not have that veto power, and they are probably just as jealous of their sovereign powers in monetary matters as we are.

Besides these specific limitations on the powers of member countries, we have already noted that both plans either imply or would probably lead to rather broad international economic controls. The controls over capital movements, for example, in order to be successful and accomplish their purpose, might well involve controls over all international transactions. There is also involved in the plans, more specifically in the Keynes plan, substantial controls over the money markets of the individual countries. As a rule these controls are left to the member countries themselves, but agreement to cooperate with the central agency and to take measures for promoting stability involves some degree of obligation to adopt such controls. It

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agrees to repurchase 40 per cent of them at the rate of 2 per cent per year for twenty years, beginning not later than three years after the date of transfer. The country in which the abnormal war balances are held must agree to transfer these balances to the Fund and also to retire from the Fund 40 per cent of them at the rate of 2 per cent a year for twenty years, beginning not later than three years after the date of transfer. Either country may at its option increase the amount of its purchases annually, under certain conditions. The Fund may dispose of its remaining holdings of abnormal war balances after the twenty-three year period, or sooner under certain conditions.

Keynes Plan -- The Keynes plan provides no detailed treatment for abnormal war balances, but its author suggests that special provision be made for converting blocked war balances into bancor.

Comment -- These abnormal war balances refer to balances blocked for lack of foreign exchange, such as the sterling balances now being accumulated by South American countries. They do not include the balances blocked in the United States for political reasons.

It is not clear how the Stabilization Fund would acquire local currencies to pay for abnormal war balances which it might purchase. If we take the case of sterling balances being accumulated by Argentina as an example, how would the Fund acquire pesos to pay Argentina for the sterling balances without depleting its regular peso assets? Presumably it could be done by borrowing from the central bank of Argentina, or perhaps by selling securities in that country. With its limited resources the Fund would probably have great difficulty in absorbing any large amount of blocked balances unless it should borrow the funds.

At any rate, the proposal for unfreezing these abnormal war balances seems to extend the process over an excessively long period. It ought to be possible to settle these balances much earlier and get them out of the way. Perhaps Argentina's sterling balances, for example, could be settled either by being refunded into long-term British securities, or by having Argentina buy back her securities held in

Other International Instrumentalities

It is apparently contemplated by the sponsors of both plans that there shall be other instrumentalities for promoting international economic cooperation and that these agencies will cooperate with and assist each other. The Secretary of the United States Treasury, in a letter to the ministers of finance of 37 countries inviting them to send technical experts to Washington to discuss suggestions for an International Stabilization Fund, said in part, "It is recognized that an International Stabilization Fund is only one of the instrumentalities which may be needed in the field of international economic cooperation. Other agencies are also needed to provide capital and for post-war reconstruction and development, to provide funds for rehabilitation and relief, and to promote stability in the prices of primary international commodities ...

"It should be emphasized that the appended draft deals only with an International Stabilization Fund. It is anticipated that there will also be submitted for consideration a preliminary draft of a proposal for an international agency whose function will be to provide capital for reconstruction and development."

In the preface to the Keynes plan, four main lines of approach to post-war problems are suggested:

1. Mechanism of currency and exchange,
2. The framework of a commercial policy regulating conditions for exchange of goods, tariffs and the like,
3. Orderly conduct of production, distribution, and prices of primary products, and
4. Investment aid, both medium- and long-term, for countries whose economic development needs assistance from outside.

The preface states further that while all these matters will need to be handled in due course, it appears convenient to give priority to the mechanism of currency and exchange.

Are They Feasible?

The vital question regarding these two plans for currency stabilization is whether they are feasible or practicable. As much as we like the objectives and admire the ingenious approach, we must face the practical question as to whether they would work under conditions that will prevail in the post-war world. In order to have any chance of success a stabilization plan would have to be coupled with other undertakings, especially measures for handling relief and for making long-term reconstruction loans. Therefore, it is difficult to pass judgment on a stabilization plan alone. The measures contemplated should all be presented as parts of a general plan and should be considered in relation to each other.

Even with the other undertakings, however, it is possible that the basic causes of disequilibrium may persist for a long time. There are many factors which prevent equilibrium in a country's payments, some internal and some external. Political instability, either domestic or international, unbalanced budgets and monetary difficulties, tariffs and trade restrictions are among them. When we consider the multiplicity of the disturbing factors that will prevail after the war it raises a question as to the wisdom of beginning with such an ambitious scheme.

We do not know what the map of Europe will look like when this war is over, or when any semblance of political stability will be restored. We do not know what countries will continue to exist in Europe, what their boundaries will be, or in what sphere of influence they will operate. The bickerings now going on between some of the United Nations do not inspire hope of any quick settlement of the world's political problems. Some of the most powerful nations may not care to cooperate in such international organizations as these, or may even frown upon the participation of the smaller nations living within their sphere of influence. Until we can develop some world-wide international political organization that can establish genuine peace and inspire confidence, it may be very difficult to get the proper degree of cooperation in economic matters.

A second factor is the economic and financial chaos that will prevail in many countries at the end of the war. Impoverished standards of living, deterioration and loss of productive facilities, unbalanced budgets and monetary troubles within many countries may make it impossible to fix rates of exchange with any degree of permanency. How can a rate be determined for the French franc, for example, until inflationary influences in that country are checked and some economic order is restored? It will be difficult to tell which countries will be able to bring about a quick restoration of internal stability and which nations may find it a prolonged and discouraging process. As a rule a currency is unstable because the country is up against difficult domestic problems, such as unemployment and an unbalanced budget, which may be tied up with internal political considerations. These would be difficult for an international body to cure. Loans and credits might afford only temporary relief and actually postpone the necessary reforms. Much groundwork may have to be done within individual countries by way of restoring their economies to stable conditions before their proper places in an international organization can be determined. Internal stability is a prerequisite to external stability. This applies to the United States as well as to other countries.

A third factor will be the disorganized and chaotic state of world trade, and the numerous trade restrictions that exist. It will take time to see how the new trade relationships are going to develop and what the effects will be on the balance of payments in particular countries. What, for example, will happen to the Dutch East Indies and their markets for rubber, tin, and other products? No doubt the problems of trade and exchange must be worked out simultaneously, but to attempt to set up an all-embracing stabilization scheme before some of these trade problems are adjusted might lead to so many maladjustments and revisions that the whole scheme would break down. Unless there is some stability and equilibrium in trade, it is almost impossible to stabilize exchanges on any sound basis. The whole problem of tariffs, quotas, and other trade restrictions is also involved.

It is true that the organization set up by each of these plans, and the allied undertakings, are designed to deal with fundamentals and to correct disequilibrium wherever it exists. If the troubles are not cured, however, and if the stabilization mechanism should operate so that these short-term credits become in fact long-term debts, the Fund or Union might be frozen up rather quickly and fail to solve the basic difficulties. The question is whether some of these basic conditions will not have to be dealt with before exchange rates can be fixed or an over-all exchange mechanism made to work. Either of these plans might work better a few years hence, after some of the more fundamental trade troubles have been remedied and fiscal problems solved.

#### Part the United States Would Have to Play

There is another vital prerequisite to the successful operation of any over-all stabilization plan, that is, the full realization by the people of the United States as to the decisions they must make and the role they must play in such a scheme. It is clear that the United States would have to play the role of the principal banker, both in granting short-term credits and in making long-term loans. This is perhaps the role we should play, but before embarking on the course we may want to analyze very carefully all the implications, the problems involved, and the chances of success. Would an elaborate international mechanism be the best method of extending these credits and carrying out our world responsibility?

It is impossible to tell from either of these plans how deeply we might become involved in the matter of extending credits and loans. The initial contribution would simply be the beginning. To prevent the stabilization agency from becoming frozen or bogging down, we might find it necessary to extend more and more credits as time goes on. The machinery of each plan is so set up that the creditor countries, which means chiefly the United States, could extend credits almost indefinitely and once started on the effort, it might prove to be the only way of extending and prolonging operations, at least for a number of years.

If we should participate in either of these plans with the determination to make it a success, therefore, we would have to be willing to implement the Stabilization Fund with large scale credits and international investments. Presumably we would be willing to forget war debts and Lend-Lease obligations. But there is still another decision which perhaps we ought to make in order to insure its success. That is a sharp reduction in tariffs in order to encourage imports and permit other countries a means of payment for American goods. We cannot expect to be very helpful in the restoration of world trade equilibrium if we refuse to receive the goods of other countries while at the same time encouraging our own exports and trying to collect war debts.

Such conflicting policies would create an impossible situation as we learned from rather costly experience after the First World War. Aside from the continued extension of war credits for five or six months immediately following the armistice, the United States held aloof from efforts to solve international economic and political problems and did little to help restore stability and equilibrium prior to 1924. When we did begin to cooperate, international conditions improved, but we still tried to collect debts and expand exports while imposing tariffs to minimize imports. Furthermore, our loans and credits were sometimes too liberal and were not always considered from the viewpoint of ultimate exchange stability. In some cases they increased exchange difficulties later, especially the short-term credits. After the world-wide depression which began in 1929 we again failed to cooperate in bringing about monetary stability and were largely responsible for the complete failure of the World Economic Conference of 1933.

The important factor is a realization of the need for bringing about conditions essential for stable exchanges and a willingness to cooperate in international affairs. Given this background perhaps an elaborate and complex international organization may not be necessary. Both the White and the Keynes plans seem unnecessarily complicated, and it might be difficult to get the American people to accept

them. Our people are essentially domestic in their trade and business activities, and to them international controls of the kind set up here might seem unrealistic and might arouse distrust. A less formalized institution might serve a better purpose initially and perhaps grow with experience in handling international matters.

Another question we might ask is whether the United States can successfully promote international stability without putting its own house in order by balancing the budget and checking inflationary influences. If we follow the kind of fiscal policy that means continuous deficits, whatever may be the excuse, the chances are that efforts to maintain international stability would ultimately run into difficulties.

A free and stable dollar in which the world has full confidence is the first prerequisite for any genuine stabilization efforts. Regardless of the standard adopted or the organization set up, some strong currency must, in fact, be the main stabilizing influence. That role was played by the British pound under the old gold standard prior to 1914.

#### Alternative Suggestion

There is much good opinion to the effect that we should begin our stabilization efforts on a more modest scale, and expand gradually to over-all stabilization. Certainly the matter cannot be allowed to drift into chaos through sheer neglect. There must be some group or agency whose primary function is to work for exchange stability.

One school of thought that has rather strong support suggests that we should first stabilize the dollar-sterling rate, with whatever credit commitments and agreements may be necessary. A number of countries will already be tied to the dollar or to the pound sterling, and a few others might be able to do so soon. The stabilization of the dollar and sterling areas would be a strong nucleus around which general stabilization efforts could center.

Other countries could gradually ally themselves with these two important currencies by making whatever adjustments or credit arrangements may be necessary. Since each country's problems are different and some can adjust much more quickly than others, this process would allow them time to work out their problems one by one until general stabilization is attained. This would involve a minimum of international organization at the beginning. The emphasis would be placed upon remedying the basic causes of disequilibrium in each country rather than undertaking general stabilization before the causes of instability are attacked.

Both the dollar and the pound would be given definite relationships to gold, and all restrictions on the export and import of gold would be removed. Therefore, the gradual stabilization of the various currencies would mean the gradual restoration of a modified international gold standard. The desire of the peoples of the world to possess gold is shown by the fact that it sells at a premium in many corners of the globe. Confidence in gold has been unshaken by the events of recent years, and its position as an international standard of value is as firmly fixed as ever.

The central banks of the world can give the necessary management to the gold standard and facilitate exchange stabilization. To provide for maximum cooperation between central banks and to facilitate the settlement of international balances, it might be desirable to set up an international bank, or to revamp the charter of the Bank for International Settlements.

This bank, however, would not be a super-organization endowed by formal agreements or rigid treaties with powers to manipulate currencies or interfere with internal matters of the various countries. It would simply be an instrumentality of the central banks, and could handle international clearings, take the lead in collecting international statistics and other information, and furnish a place where the central bankers of the world could meet and discuss their respective problems. Perhaps more could be accomplished in this informal manner than by more



One function of the international bank might be to make detailed studies of the exchange problems of the various countries and to advise them regarding these problems. It might aid in the negotiation of stabilization credits and in the servicing of loans. In time such a bank might extend its influence and prestige and become a central stabilization agency with broader powers, if such a development should seem desirable. It might perform some of the functions envisaged by the White and Keynes plans, but these functions would develop out of experience in handling issues as they arise.