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NOTES ON DISCUSSION OF CURRENT PROPOSALS FOR INTERNATIONAL CURRENCY STABILIZATION

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The discussion with directors and officers of the Bank was led by E. A. Goldenweiser, Director, Division of Research and Statistics, and Walter Gardner, member of the staff of the Board of Governors. To avoid undue repetition this digest of the discussion is organized systematically rather than in the order in which the several points were considered at the meeting.

I. Currency stabilization is a part only - and by no means the most important part - of the problem of post-war reconstruction.

It is important in all discussions of currency proposals to recognize that that post-war world will be confronted with many extremely difficult problems that cannot be solved through reconstruction of currencies. Illustrative of these problems are the following:

1. Problems of food distribution, restoration, and rehabilitation in the immediate post-war period, including possibly gifts, loans, lend-lease, etc.
2. Adjustments in internal economies arising directly from the war, illustrated by
   a. Great Britain

   Prior to the war Great Britain was able to import more than she exported, principally because of the income received on her foreign investments. These have been reduced considerably though not as much as is sometimes supposed - say by one-third including some of the best, especially American investments. If Great Britain is to secure a higher standard of living after the war, it must be achieved with a smaller import balance. Nevertheless, the task is not hopeless. During and as a result of the present war, she has replaced an antiquated technology. A better system of production and domestic distribution would seem to point the way to a solution of this problem.

b. The East Indies

The development of synthetic rubber will require fundamental adjustment in the East Indies' economy.

3. Adjustments made necessary by fundamental changes in demand, illustrated by:

a. Silk

The whole Japanese economy was built upon silk. The economic pressure upon Japan which resulted from the decline in the demand for silk (substitution of other materials) was, at least partially, responsible for the Japanese invasion of China.

II. <u>Why start with currency stabilization if other problems are more important?</u>

1. Stable currencies are an important aid in the solution of other problems.

2. Because of extensive experience with currencies, a great deal is known about them and - though difficult - the problem is easier

of solution than other problems.

III. Responsibility versus sovereignty

Some people hold the opinion that the United States has a clear-cut choice in currency matters between maintaining its sovereignty and delegating it to some international organization. They feel that entry into any international monetary arrangement would create a great responsibility for the United States and that such entry would diminish our sovereignty. Actually, however, a great responsibility exists - whether an international organization is created or not - and the real question is how it can be discharged most effectively. It appears better to anticipate and to organize to meet problems as they arise than to have them inchoate and indefinite.

It is easily possible to overestimate the degree of sovereignty that a nation actually has in currency matters or how much actual freedom of choice it would have to forfeit under a plan. As long as a country's balance of international payments remains in equilibrium, it will be subjected to no external compulsion either with or without an international agency. If a fundamental disequilibrium develops, it will be under economic pressure to adopt actions to restore equilibrium either with or without an agency. Furthermore, the alternative actions that a country may undertake are the same with or without an agency. If a country has a so-called "unfavorable balance", it must either borrow or somehow or other increase its visible and invisible exports relative to its imports. To alter its balance of payments position, it must either devalue, adopt restrictive credit measures relative to the rest of the world, or restrict its imports.

If a country has a "favorable balance", it must lend abroad or increase its imports relative to its exports. To restore balance in its international payments it must revalue upward, adopt an easier credit policy than the rest of the world, or reduce its import restrictions, such as tariffs. (The analysis is developed more fully in the Supplementary Memorandum.)

The fundamental purpose of current proposals is two-fold. In the first place they would provide a lending agency which would enable countries to "tide-over" purely temporary disequilibria. In this respect they would increase the sovereignty or freedom of action of individual countries, because the need to adjust to fortuitous circumstances would no longer be necessary. In the second place, current proposals would provide an agency which would analyze the particular causes of disequilibrium in actual cases and would recommend an <u>orderly and systematic plan</u> to restore equilibrium without devastating other nations, which devastation would result eventually in loss to the initial offender. The right to withdraw from the plan would enable a country to restore its "freedom", but <u>withdrawal would not restore its equilibrium.</u> If too many countries were to withdraw, of course, either or any plan would collapse.

Experience also shows that it is possible to overestimate the tenacity with which citizens cling to the fetish of absolute sovereignty. For example, when nations adhered to the gold standard they were in fact willing to let the vagaries of this metal determine the value of their own currencies. They surrendered their sovereignty over money to gold. Although it is true that they could reestablish sovereignty at any time, this is possible also under an international monetary arrangement which permits member states to withdraw. In addition, history is replete with examples of countries that have abandoned their sovereignty in currency matters much more obviously. For example, in the inter-war years, many countries employed Professor E. W. Kemmerer to devise monetary systems for them; and they followed his advice. It does not seem unreasonable to ask countries to adopt plans proposed and developed by many people in a democratic way.

IV. Relation to the Federal Reserve System

In addition to its broad general policies, the Federal Reserve System has a day-to-day responsibility with respect to bank reserves. In its early days the member banks of the Federal Reserve System operated with no excess reserves. It was possible at that time for the Reserve System to exercise pressure through comparatively small contractions in the reserves of member banks. Similarly, credit conditions could be eased effectively by a small increase in reserves. For almost a decade, however, member banks have had large excess reserves and although they are small at the moment, they may very easily be large again after the war.

Therefore, if the Reserve System is to discharge its responsibilities effectively, it must:

1. Estimate as accurately as possible the size of the job that it will be expected to do.

   Especially, it must estimate the amount of reserves that any currency plan might create. The following estimate was made of the international buying power which could be focused upon the United States under the two plans. Both would begin with the $11 billion in gold now held outside the United States. The original White plan would add between $2 and $3 billion, making a total of $13 to $14 billion. The original Keynes plan would add approximately $27 billion, making a total of $38 billion. This is now recognized to be too great. Because of the technical features of the Keynes plan, whereby <u>all</u> of the debit balances of other members <u>could be</u> concentrated against a single member, it would be impossible to reduce the total quota as low as it is in the American plan without destroying its ability to accomplish its purpose. Under the Keynes plan the only way to reduce the total claims that may be exercised against the United States is to reduce the aggregate of all the quotas. But, if total claims were reduced sufficiently to reduce the problem to manageable proportions for the United States, the amount that could be distributed among the members would be too small.

Under the White plan other members cannot secure claims against the United States in excess of dollar and gold holdings of the Fund. In a current revision, the White plan calls for a total of $10 billion which might result in a maximum addition of claims against the United States of $5 billion instead of roughly half that amount.

2. Consider seriously the necessity of securing additional powers to absorb excessive reserves. Present control powers would not be adequate.

3. Study qualitative controls.

The System now exercises two such controls - Regulation T with respect to brokers' loans and Regulation W with respect to consumer credit. It is clearly possible that it may be expected to exercise similar controls in other fields, for example, commodities or real estate. At first glance, the implications of such an extension of control may be frightening but the problem must be faced.

V. Over-all versus key-country approach

It seemed to be the consensus that, if the problems involved were thoroughly understood by all people, the over-all approach would be preferable; but that in existing circumstances, the key-country approach might have a better chance of adoption in the United States. On the other hand, the attitude of the Russians at present is not known; it is an enigma. It is quite possible that Russia would refuse to enter a program based on the key-country approach and that South American countries would certainly be suspicious of such a system.

It might be possible to revamp the Bank for International Settlements as the international agency for currency stabilization. The unique contributions which the B.I.S. could make would, however, be limited. It would not be able to secure the necessary resources on the basis of its present organization, and its reputation has been seriously impaired recently, especially in England.

It was recognized that the repercussions would be smaller if a plan based on the key-country approach were to fail than if an all-inclusive plan failed. At the same time, a key-country plan would not have the psychological values, particularly for smaller countries, that would accrue to the adoption of an over-all plan. Under the key-country approach, major decisions would still be made in the twilight of the wings rather than in the spotlight of the center of the stage.

VI. Rates of exchange

The question of the establishment of initial rates of exchange and subsequent modifications is receiving extended consideration. The importance of the initial rates established is clearly recognized and extensive modifications to make them more flexible, at least in the early years, have been made.

VII. Nature of the assets under the two plans

On the surface the Keynes and the White plans differ with respect to the nature of the major asset held by the proposed governing agency. Yet the differences are more apparent than fundamental. The Keynes plan is based upon the overdraft principle, which is customary in English banking. The procedure under this principle differs from that followed under the deposit principle, which is customary in the United States. In the United States when a customer borrows from a bank, he signs his note and receives a deposit credit. In England the borrower makes arrangements with his bank to overdraw his account. When the customer to whom he has given the check deposits it in the bank, the bank credits the account of the customer and debits the account of the borrower. It will be noted that in both cases the assets of the bank consist of a claim against the borrower, but that credit actually extended in the case of England reflects only the amount actually in use.

Under the Keynes plan, which is based on the overdraft principle, no tangible assets are turned over to the Union. Its assets are created when members draw upon their quotas. But they are not unreal. They are claims that member states have agreed to honor.

Under the White plan, the member states may contribute domestic currencies, domestic government securities, and gold. To the extent that the contributions consist of currency and securities, the only difference between the assets of the White Fund and those of the Keynes Union is that the former consists of engraved obligations of member states. At first impression, the contribution of gold under the White plan appears to be much more substantial. The chief function performed by gold is its service as a claim on foreign goods - a claim that can be exercised only if it has an import balance. In short, the gold contribution under the White plan - like the currency and security contribution under the plan, and like the debit balance contribution under the Keynes plan - consists of an asset that may be used to pay foreign debts.

VIII. Gold

Keynes has been concerned for a long time with the fact that under the gold standard the volume of the currencies of the world is dependent upon the world stock of gold. The world stock of gold, the discovery of new mines, the exhaustion of old mines, and other factors affecting gold have no relation to the amount of currency that the world needs. In addition, much effort is devoted to digging gold out of the mines, burying and guarding it at Fort Knox. This effort might be employed to better human advantage. At the same time, Keynes recognizes that gold still possesses great psychological value and that it is doubtful that any plan which would dispense with it could be adopted, particularly in the United States, which has a stock worth $22 billion and South Africa, the world's major producer. In reconciling his fundamental theoretical position with the factors in the real world, Keynes would supplant gold as a governing factor but would not dispense with it.

A major objection to gold has been that at least in recent times the world has not had enough of it and that the supplies have been improperly distributed. Keynes' plan, therefore, proposes that the quotas under his plan be used as a supplement to existing gold stocks so that gold may no longer be master.

The White plan, while based upon gold, makes no more mention of the metal than is necessary and seems to be built on the hope that somehow gold may not lose its power even though it is implied that it is not a satisfactory regulator of world currencies.

The only possible use - other than comparatively small amounts that may be used in the arts - of our present gold holdings of $22 billion is to make international payments. And it can be used in this way only if we have an import surplus.

IX. Technical matters worthy of attention

1. The term "stabilization"

The choice of the word "stabilization" is unfortunate. Since to some people it recalls the failure of the inter-war period, any plan which bears the word is suspect. People recall the Dawes and the Young plans. Although "stabilization" describes accurately the purpose of the current plans, a word with better psychological appeal should be found. Offhand there was no suggestion as to what the word might be.

2. Quotas and voting power

The original proposals of both the Keynes and the White plans with respect to quotas and voting power have been recognized generally to be unwise. The British experts now in Washington - D. H. Robertson, Lionel Robbins, R. Opie - agree with the American experts that the total of the quotas originally proposed by the Keynes plan is far too great. The distribution of the quotas among the member states is also being modified. It is clear, for example, that any quotas based upon trade must be modified in the cases of Russia and China. The distribution on the basis of pre-war world trade would not, however, require a restoration of the trade of the several members to their pre-war position. The quotas could be readjusted as world trade shifts among the members. Just as foreign trade did not formerly conform to the gold holdings, so it would not be necessary for post-war world trade to conform to quotas.

Among the proposals for changing quotas was one which would base them upon the reduced volume of export trade during the 1930's. It was supposed that this would greatly increase the quotas of raw material countries relative to the industrial countries. Examination of the data, however, showed that this was not true to anything like the extent supposed, the reason being that although the raw material countries suffered severe declines because of decreases in price, the industrial countries also suffered severe declines because of decreases in physical volume.

3. Publicity

More care should be exercised in discussions of the plans to indicate that they have narrowly restricted objectives. The reaction of the public to the publicity thus far is that the plans are panaceas. Until current proposals are crystallized to greater extent than they are at present, the less publicity or no publicity at all the better. Even restricted meetings beyond the Reserve System family are not desirable.