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INTERNATIONAL MONETARY FUND

(PURPOSES, METHODS, CONSEQUENCES)

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Much confusion about the International Monetary Fund would be avoided if it were clearly understood that there are three separate aspects in the proposed plan: one, the Fund's purpose; two, the methods proposed for achieving this purpose, and, three, the consequences that may flow from its achievement.

The purpose of the Fund is the restoration of world trade and its continuing expansion. While the agreement proposing the Fund deals for the most part with matters relating to foreign exchange and the maintenance of its stability, that after all is not an end in itself but merely one of the means towards achieving better trade conditions. Similarly, while the Fund may be expected, through improving trade conditions, to contribute to the maintenance of full employment and a high level of real income as well as to the restoration of disrupted economies and the development of resources of undeveloped countries, these matters are in the nature of hoped for consequences of the successful operation of the Fund rather than its immediate purpose.

A brief discussion of the three phases of the matter is presented in the following paragraphs. No attempt is made to describe the Fund's operation or to cover all the matters with which the proposal deals. That has been done in other papers. This is only an attempt to draw a sharp distinction between the Fund's purposes, its methods, and the possible consequences of its operation.

PURPOSE

No country is completely free from the influence of foreign trade. Raw material producing countries need foreign trade in order to find markets for their output. These countries need the proceeds of the sale of their products abroad for the purpose of buying goods for consumption as well as for the development of their country. Industrial countries usually require foreign trade both for the acquisition of raw materials which they use in manufacturing and for the disposal of their products. There are great differences between countries in the extent to which they depend on foreign trade. In some countries foreign commerce constitutes a very large proportion of total national income. In other countries the percentage of national income that is produced by foreign trade is small. But even in the latter countries it is often the case that the marginal 10 or 12 per cent involved in foreign trade may spell the difference between prosperity and depression.

For these reasons, a restored world economy cannot be imagined without the establishment of world trade on the largest possible scale and with the least possible obstructions. This need not be elaborated; suffice it to recall the innumerable difficulties and frictions which developed in the two decades after the last war as a result of increasing obstructions to world trade. If the Monetary Fund can make a substantial contribution to its restoration in the maximum possible volume it will not have been in vain that the representatives of 44 nations spent much time and effort in promoting and fashioning the plan.

METHOD

The greater part of the proposed agreement deals with the methods devised for the purpose of encouraging world trade. The principal method is the restoration of exchange stability. Assurance to producers and traders throughout the world that they can count on a reasonably stable level of exchange rates would make it very much easier for them to engage in their business. They would have the assurance that their profits will not be exposed to the unpredictable risk of great fluctuations in the value of the currencies for which they propose to sell their product or in which they propose to pay for their imports. Exchange stability affects directly not only those who are engaged in international trade but also all those who produce goods a considerable part of which finds its way into world markets. It is, therefore, not a matter that concerns merely a relatively small proportion of some countries' population but one that directly concerns the great majority of all people. In fact, no prosperous world trade and no prosperous economies can persist in the face of violent fluctuations in exchange. It is for this reason, and as a result of painful experience, that the great necessity for developing an International Monetary Fund was ~~devised.~~ recognized

More specifically, the Fund proposes to limit the right of member countries to change their exchange rates without going through a certain procedure. The countries that join the Fund undertake not to propose such changes unless they consider them appropriate to the correction of a fundamental disequilibrium.

While the Fund looks to exchange stability as the principal means for the restoration of world trade, it recognizes limitations on stability that are necessary in order to meet the internal conditions of different countries. It provides that during the period of transition, in view of the extreme uncertainties that must prevail after the war comes to an end, many adjustments will be necessary, and it is proposed that the Fund in deciding on its attitude to any proposals for changes in exchange rates presented by members shall give the member country the benefit of any reasonable doubt. It is indeed impossible to conceive of a Fund possessed of such wisdom as to provide immediately after the war rates of exchange that will in all cases continue to be appropriate as the process of reconstruction proceeds. There is, therefore, an indication that the Fund will have an open mind in this matter and will proceed with due consideration for the needs of applying countries.

The Fund also has other provisions that add flexibility to the system it hopes to establish. It authorizes a country to make a 10 per cent change in its currency without obtaining the concurrence of the Fund. However, even in that case the country is required to consult with the Fund and to act in accordance with its purposes, so that if the agreement is carried out in good faith such changes will not be an arbitrary or competitive devaluation. Furthermore, the proposal provides that a country which after having made a 10 per cent change finds itself under the necessity of making another change without delay, may request the Fund's concurrence in such a change and a reply must be given within 72 hours. Other changes can be obtained with the Fund's concurrence and there are no prescribed limitations to the time necessary for their consideration.

It may appear that these provisions go a long ways towards diminishing the hoped for stability of exchanges. Careful consideration, however, would indicate that the opposite is the case. Stability does not mean rigidity, and rigidity in the past has resulted in extreme instability. A country which finds that its domestic economy is suffering greatly from inability to sell abroad, because of an inappropriate rate of exchange, has no alternative but to change it. If it does not change it soon enough but persists in maintaining it after it has become untenable, there are serious consequences both at home and abroad. Ultimately the rate is changed and is likely to be changed by a larger amount than would have been necessary if the country had acted promptly. Illustrations of such cases are too common to need mention.

Therefore, the provision for moderate changes in consultation with an International Fund and with its concurrence, so long as they are in accordance with the general objectives of the Fund, is a real contribution to stability rather than an impingement upon it.

In order to protect the economies of the country from any untoward influences resulting from excessive rigidity of the rate, there is an explicit provision that the Fund shall not reject a requested change that is necessary to restore equilibrium, on the ground that it does not approve of the domestic social or political policies of the member country, or of its economic policies in so far as these contribute to the maintenance of a high level of employment and real income. These provisions are not a substantive limitation on what the Fund is expected to do, but merely a reassurance to the countries that these vital matters were kept in mind by the framers of the proposal, and the member countries' inherent autonomy in domestic affairs is not threatened.

As a part of its mechanism for the restoration of world trade the Fund provides a method of affording countries an opportunity in effect to borrow foreign currencies from the Fund, in exchange for their own. This enables countries that are temporarily out of means for making payments abroad to make such payments out of the Fund's resources. The countries are thus protected from feeling immediately the pressures arising out of an unfavorable trade balance in a way that leads to disruption, measures of restrictions, blocked accounts, limitations of trade, etc.

There are many safeguards provided in the Fund to protect its resources from uses that are excessive in amount or in duration. The Fund is expected to be a revolving fund which affords to the countries a breathing spell during which they can undertake such measures as may be necessary to restore their economy to a condition of equilibrium without in the meantime disrupting their foreign trade. No safeguard provided for the Fund is more important than the provision that the countries' request for foreign currencies must indicate that the uses to which those currencies will be put are consistent with the purposes of the Fund. This means that countries which conduct their affairs in good faith in accordance with the undertaking to act in conformity with the purposes of the Fund will not in any circumstances divert the resources of the Fund to undesirable uses. In international agreements between sovereign States no method of enforcement can be as important as reliance on the good faith of the participants. The Fund's operations are limited to current transactions. With reasonable exceptions, the Fund is not supposed to be used for the transfer of capital. Such operations must be handled through other channels.

An important incidental provision in this connection is the power of the Fund to warn a member country, even though that country may not be using the Fund's resources, that the conduct of its affairs is not consistent with the purposes of the Fund. Such a warning would point out to the country that its conduct not only constitutes a failure to perform an obligation undertaken by joining the Fund but will be prejudicial to the country if in future it should wish to have recourse to the Fund.

To summarize, the Fund attempts to provide the greatest degree of exchange stability that is consistent with the economic necessities of the members. It introduces stability without rigidity and elasticity without looseness.

CONSEQUENCES

In drafting the proposal it has been the intention not only to indicate the purpose and the methods of the Fund but also briefly to mention the consequences that it may have on world prosperity. As a means of assuring the member countries that join the Fund that it is not conceived in the narrow spirit of protecting the financial interests of traders and their backers but in the spirit of far-sighted concern about the general well-being, it is indicated that the Fund proposes to contribute to the promotion and maintenance of high levels of employment and to the development of the sources of productive power in all member countries, as primary objectives of economic policy.

The Fund does not propose to be a universal panacea for all human ills but only a mechanism for the performance of a clearly defined specific purpose. At the same time it is one of the cogs which, in conjunction with many other undertakings, offers hope for the re-establishment of a prosperous and, consequently, a peaceful world.