THE BANKERS' ASSOCIATION REPORTS ON BRETTON WOODS

Although the reports of the American Bankers' Association and the New York State Bankers' Association differ as far as presentation, accuracy, and degree of detail are concerned, they take substantially the same positions on all matters of importance. Both reports oppose establishment of the Fund and favor acceptance of the Bank plan with such amendments as are necessary to enable the Bank to take over some of the functions of the Fund. The arguments against the Fund are many but they revolve around two main points: (1) that members have what amounts to a right to borrow from the Fund and the Fund's resources are therefore bound to be abused; and (2) that the Fund plan recognizes too much flexibility of exchange rates and permits too much exchange control.

1. The Right to Borrow and Abuse of the Fund's Resources

The reports say that members have an implicit right to borrow from the Fund and that this is obviously contrary to accepted banking principles. They are convinced that members will abuse their borrowing privileges and the Fund's resources will be wasted.

Proponents of the Fund have explained that members can borrow in general only to meet payments due for goods and services and that the Fund can at any time declare a member ineligible to use the Fund if it is using the resources of the Fund in a manner contrary to the purposes of the Fund. The association reports say that these limitations are too general to mean anything. Although the phrase "in accordance with the purposes of the Fund" is general, the purposes themselves are more specific. The two purposes which are especially relevant are:

> "To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
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> "In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members."

These purposes make it quite clear that the Fund's resources are to be used to help countries meet temporary trade deficits and to give them an opportunity to correct more deep-seated maladjustments.

The bankers emphasize, however, that it will be difficult to decide in a given case whether credits are being used in accordance with these purposes. The corrective measures needed and the extent to which they might be destructive of national prosperity are matters upon which there may be serious differences of opinion. This is true of course. The management of the Fund will have to weigh conflicting considerations. The success of the Fund will depend in large part on the management but this is the case with every institution.

The reports emphasize particularly the fact that a member can borrow from the Fund to meet an adverse trade balance unless and until the Fund objects. This indicates, in their opinion, that resources of the Fund are bound to be wasted before the Fund can object. A country may borrow even though its budget is not balanced, for example, or its financial policies are such as to result in a chronic trade deficit, Furthermore, they believe the Fund will not step in when it should because members have been led to expect credits and will exert political pressure on the management of the Fund.

The associations do not seem to realize that the fact that members can come to the Fund and expect help under certain conditions, and until the Fund objects, is at the very core of the whole Fund Agreement. Foreign countries would not be willing to accept firm commitments on exchange rates and exchange controls unless they had this feeling of confidence. Furthermore, there are bound to be many cases in which an adverse trade balance is essentially a temporary phenomenon and use of the Fund will prevent disturbing and destructive measures. If a drop in France's exports leads immediately to defensive deflationary measures and restriction of imports her exchange difficulties will spread to other countries and a vicious circle of restrictions on trade and deflation will be set in motion. If France, with the help of the Fund, can maintain her imports a whole series of deflationary and depressing reactions may be prevented. It is imperative that a country should be able to get credit without delay in such circumstances because any delay may lead to a series of expectations of further difficulties and aggravate the situation. The bankers' proposal that the Bank should sit back and analyse the situation and stipulate a whole series of conditions before making a loan to France would destroy the very important sustaining effects of the Fund system.

Furthermore, there is no way of telling when a deficit first develops what has led to the deficit and just what measures are required. The bankers' idea of making individual stabilization loans on condition that the borrowing government balances its budget, establishes a new government, raises interest rates, etc., is really based on experience in the 30's when the bankers, after a period of instability, deflation, unemployment, and exchange depreciation, made a loan to a country when that country was already in a position in which it had to do something drastic to get back on its feet. The Fund aims, once members have achieved sufficient stability to be eligible to borrow from the Fund, to prevent any country from getting into such a position. Under the Fund plan there will have to be specialists watching the situation in France and every other country and especially their borrowings from the Fund. If France should borrow continuously from the Fund these specialists will set to work to analyse the situation. They may warn the French authorities that certain corrective measures are necessary. Once France has started to borrow from the Fund she will not want to be declared ineligible to borrow further and will be receptive to the views of the Fund. The efforts to correct the situation will be the subject of the best possible advice and altered as the situation develops. The Fund method aims to keep a country in a standing position, not merely to help it to its feet after a fall, The Fund aims to influence every country to keep its house in order, not to force countries to put their house in order after months or years of neglect.

It is true that you can not start with the idea of keeping a house in order if it is already badly in need of a thorough overhauling. That is why the Fund plan makes it clear that members do not become eligible to borrow in any automatic fashion. The Fund must decide that a member has achieved sufficient stability to make good use of the Fund's resources before the member is allowed to borrow from the Fund at all. In the immediate post-war period the bankers' procedure has its place. But once members have achieved a reasonably sound position the Fund procedure offers much greater chances of sustained stability.

It is quite true that the Fund procedure will work only if the Fund does exercise its power to declare members which are not playing the game ineligible to borrow. The length, and the importance attached to, the discussion of this power both at Atlantic City and Bretton woods are testimony to the fact that the countries represented do not consider that they have an implicit right to borrow or that the management of the Fund is not intended to control use of its resources. The management must be able and courageous, of course, and not subject to all sorts of political pressures. But surely the same thing is true of the Bank proposal in spite of its thoroughly conventional provisions concerning loans for long-term development and reconstruction projects.1/

The bankers' associations are concerned not only with the use of funds borrowed by members but also with the conditions governing repayment. They dislike the idea of no specific time limit on loans and think the deterrent (interest) charges are too low. They point out that the repurchase provisions will ensure repayment in some cases but not in others. I am sure that, if they had any confidence, as the proponents of the Fund have, in the Fund's ability to preserve some degree of stability in international monetary relationships they would not be unduly worried about repayment.

There are several other objections to the Fund proposal on the part of the bankers' associations which grow out of their contention that members have an "implicit right" to borrow and that the Fund will not be able to prevent abuse of its resources.

(a) They say there is no general need for assistance on the tremendous scale of the Fund plan and cite large gold and foreign exchange reserves held by many countries. This argument is not very convincing in view of the following facts: several countries will use a large part of their reserves to meet immediate post-war needs; in many countries the reserves are tied up in meeting legal reserve requirements; all of the major countries have independent reserves in excess of their quotas and have to use up their reserves at the same rate as they draw on the Fund; even countries with large reserves may restrict foreign trade

1/ One point the bankers fail to elucidate is what kind of provisions they would favor as far as stabilization loans are concerned. The existing provisions are obviously not applicable. There is every reason to believe that the type of conditions the bankers would like to specify would not be acceptable to any of the major foreign governments.

or adopt deflationary measures rather than lose substantial quantities of gold; and as of March 1944, 22 of the member countries with quotas amounting to 2.5 billion out of foreign quotas totalling 6.1 billion, had gold and dollar reserves equal to 50 per cent or less of their 1929 exports and trade will certainly reach higher levels after the war. Furthermore, the Fund does not make huge sums available: maximum loans will be nearer $4 billion than $8 billion. And the annual maximum drawing privilege of all but 2 countries other than the United States is less than 20 per cent of the value of their exports in 1938 and of 26 countries is less than 10 per cent.

(b) The reports object to setting up the Fund in the transition period primarily because of distrust of the Fund's lending methods. They seem unimpressed by two safeguards which are certainly of the utmost importance. First, the Fund may postpone all exchange transactions until conditions are reasonably stable. Second, the Fund can postpone transactions with any one member until it is in a position to make good use of the Fund.

Fear is expressed in the reports that the resources of the Fund will be used for relief and reconstruction. It is true that any credits granted in the transition period to a country in need of relief or reconstruction credits will indirectly help that country to meet its relief or reconstruction needs. The Fund can surely prevent substantial use of its funds for such purposes however. It must be remembered also that there is little chance of the Fund being engaged in exchange transactions before late in 1946. By that time immediate relief needs in Europe will have been met, and the Bank will be able to help finance reconstruction. Furthermore, annual borrowing privileges are small enough to prevent any serious drain in a period of one or two years.

The reports also refer to credits being wasted in the transition period in supporting exchange rates which can not be maintained. Here the general uncertainty and lack of clarity as to their whole position on exchange rates and exchange controls becomes apparent. The problem is discussed below.

(c) Because the bankers are convinced that loans will be misused and not repaid in a reasonable time, they think the Fund is pretty sure to run out of dollars. When this happens they believe the United States will be under heavy pressure to lend more to the Fund. If the Fund is reasonably well managed and still runs out of dollars it will be because, despite the Fund's influence, the United States balance of payments with other member countries has been favorable to the amount of at least $6 billion. Exhaustion of the Fund's dollars will make it quite clear to this country that our failure to balance our international transactions has made it impossible for us to maintain our exports unless we buy more abroad or lend more abroad. The fact that this situation will be made clear is probably a very good thing. It may induce us to lower tariffs or expand our income. Furthermore, I do not think it would be impossible for the United States to refuse to lend more to the Fund at that time. There is already considerable understanding of the possibilities of maintaining exports by loans and yet the opponents of government foreign lending programs are able to win tremendous support.

2. Exchange Rates and Exchange Controls

The whole object of the Fund plan is to achieve reasonable stability of exchange rates and the elimination of exchange controls. The Fund's resources are to be used to help countries to live up to their commitments as far as exchange rates and exchange controls are concerned. In this most crucial and difficult area the bankers' reports are unconvincing and unclear.

Both reports take the general position that the Fund provides for more flexibility of exchange rates than it should. There is reason to believe that the bankers are confusing rigidity with stability and are not fully aware of the fact that permitting necessary changes will contribute in the end to stability.

The New York Bankers' report raises a number of objections to the precise language of the proposal. They object to the fact that "fundamental disequilibrium" is not defined and to the fact the Fund is not to reject a change in rates "because of the domestic social or political policies" of the member requesting the change. These specific objections to language are unreasonable. With no definition of fundamental disequilibrium the management of the Fund is quite free to develop its own criteria. Any specific definition might force the Fund to approve changes they would not otherwise approve. The clause about "domestic social and political policies" does not reduce in any way the absolute power of the management to decide whether or not a change in rates is necessary to correct a fundamental disequilibrium. If a large government spending program for social security is leading to a rise in incomes and prices which is making it difficult for Britain to maintain the established rate the Fund can point out to Britain that a change in rates will not correct the situation because a new rate would soon be out of line if Britain continued her government spending program. The Fund may decide to grant a change to offset whatever rise in prices has already taken place or it may not. It may point out that contraction of government spending can correct the situation. If it does approve a change in rates to meet the existing level of prices and income it can certainly refuse to lend to Britain to support the new rate if Britain continues her spending program. It can thus exert great influence on Britain to give up a policy which would be bound to lead to the necessity of further rate changes.

The reports believe that differences of interpretation between the British and Americans on the subject of exchange flexibility show that the Fund provisions on exchange rate changes will be unworkable. They do not seem to realize that public statements both here and abroad are bound to exaggerate somewhat the phrases which will be most popular. They neglect to point out Britain's real and long-standing interest in the reasonable stability of sterling. The British want to have some confidence that a change will be approved when they have reached a situation like that of 1931 and a change in rate seems absolutely necessary. But this does not mean that the British will be seeking to change their rate frequently or that in the actual situations which arise there will be great difference of opinion between the British and American representatives on the Fund.

All the comments in the reports on exchange rate flexibility become difficult to understand when it is realized that the reports recommend, instead of a firm principle of changes (beyond 10 per cent) only with approval of an international body, that agreements for consultation on exchange rates be added to the Bank plan. How could mere consultation persuade a country to not change its rate if outright Fund objection would not? Perhaps the bankers would want the American representatives to be able to oppose any change and not even be governed by the principle of granting a change when necessary to correct a fundamental disequilibrium. This would lead to all the exchange rate fluctuations and difficulties of the 30's rather than to stability of rates.

As far as the transition period is concerned, both reports imply that changes in rates will be necessary and therefore object to the Fund's resources being used to help maintain rates. Surely, however, the bankers would not want to see a repetition of the fluctuating rates from 1919 to 1925. Such fluctuations lead to world-wide disturbances. Under the Fund proposal it is provided that somewhat greater flexibility shall be allowed in the transition period. Neither the Fund nor the member countries will have any incentive to waste the Fund's resources in trying to support untenable positions, and the mere existence of the whole Fund Agreement will contribute in an important way to confidence in the currencies of member countries and thus prevent disturbances which would otherwise occur.

Both reports take the same kind of attitude on exchange controls that they take on exchange rates. They say the Fund provides for maintenance of and approval of too much in the way of exchange controls. They object to particular detailed provisions as being too weak or sanctioning objectionable types of controls. But their own proposal is merely that there be provision under the Bank Agreement under which all members agree to the gradual removal of controls and consultation on exchange controls. It is very difficult to see how mere consultation could accomplish as much as the provisions in the Fund plan which give the Fund power to require removal of controls and the power to refuse to approve of any introduction of new controls. They are afraid the Fund may never succeed in eliminating controls. But their own proposal would be much more apt to lead to a greater and greater reliance on and tightening of controls. Under the Fund plan a member which tries to relax controls has some confidence that it can draw on the Fund to meet a temporary deficit. Furthermore, under the Fund plan a country which does not relax controls as quickly as possible can be refused credits, or even suspended from membership.

The New York Bankers' report says the Fund can only require removal of controls "in exceptional circumstances" and thinks this language puts a heavy burden of proof on the Fund. But it must be remembered that this clause simply recognizes that it would be evidence of bad faith on the part of members if they did not relax controls as quicly as possible and that the Fund does not expect members to act in bad faith.

The New York Bankers' report also quotes Keynes as saying that nothing in the plan would prevent a barter trading agreement requiring some matching of imports and exports with particular countries. There is no difference of opinion on this issue between the Americans and British who understand the whole problem. The Fund does not have anything to say about quantitative trade restrictions, quotas, tariffs, etc. The regulation of such practices must be taken care of under an international commercial policy agreement. Elimination of monetary controls would accomplish little if trade controls were not also eliminated, and vice versa.

The New York Bankers' report is also very much concerned because the Fund permits complete freedom to control capital movements. They say that control of capital movements is impossible without some supervision of all exchange transactions. This is quite true but they seem to imply that supervision of all transactions means restrictions on all transactions. This is not true. Members are bound not to restrict payments on current transactions and can control capital movements provided the controls are not exercised "in a manner which will restrict payments for current transactions."

It is surprising that the New York Bankers' report does not recognize that most members will not control capital transactions except in periods of difficulty and that control of capital transactions in such circumstances is absolutely essential for the maintenance of international monetary stability. Speculative capital movements were one of the most disturbing factors in the inter-war period and might take place on an even larger scale after the war if completely unchecked.

It is again difficult to understand just what the bankers contemplate in the transition period. They don't like the idea of loans being readily available, they don't like exchange rate changes, and they don't like exchange controls. But one or another of these methods will have to be resorted to and a reasonable combination of the three is provided for under the Fund Agreement. The bankers are not following the position of John Williams on exchange controls. He definitely believes that exchange controls should be relied on in the transition period. The bankers want as little as possible of all three and seem to have unbounded faith in the extent to which internal stability and putting one's house in order can eliminate balance of payments and exchange difficulties. It is quite unreasonable to think that internal measures can cure all balance of payments problems, and especially that they can do so without leading to very serious internal maladjustments.

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