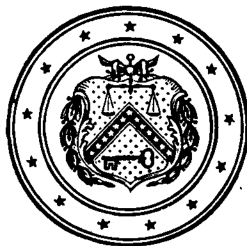
THE BRETTON WOODS PROPOSALS



U. S. TREASURY
WASHINGTON, D. C.
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THE actual details of a financial and monetary agreement may seem mysterious to the general public. Yet at the heart of it lie the most elementary bread-and-butter realities of daily life. What we have done here in Bretton Woods is to devise machinery by which men and women everywhere can exchange on a fair and stable basis, the goods which they produce through their labor. And we have taken the initial step through which the nations of the world will be able to help one another in economic development to their mutual advantage and for the enrichment of all.

—From the address closing the Bretton Woods Conference.

By HENRY MORGENTHAU, Jr.,
Secretary of the Treasury,
President of the Conference.

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THE BRETTON WOODS PROPOSALS

Introduction

Bretton Woods is the symbol of a new kind of cooperation. It stands for proposals looking toward cooperation in the solution of international monetary and financial problems. Drafted by representatives of 44 nations in a conference called on the invitation of President Roosevelt at Bretton Woods, New Hampshire, in July 1944, the proposals are the outgrowth of three years of study by the technical staffs of the Treasury, State Department, Board of Governors of the Federal Reserve System, and other agencies of the United States government. For a period of more than a year, informal discussions were held with representatives of other governments associated with us in winning the war.

As part of the economic foundation for a peaceful and prosperous world, the Bretton Woods proposals call for the establishment of two international institutions, the International Monetary Fund and the International Bank for Reconstruction and Development. Although related in purpose, these institutions will perform quite different functions. The Fund will be concerned with the maintenance of orderly currency practices as they relate to international trade, while the Bank will facilitate the making of long-term international investments for productive purposes.

Acceptance of the proposals by the United States will require Congressional action.

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THE INTERNATIONAL MONETARY FUND

What the Fund Will Do

The fundamental purpose of the International Monetary Fund is to promote the balanced growth of international trade. It will do this in three ways. First, it will stabilize the value of all currencies in terms of each other. Second, it will progressively remove barriers against making payments across boundary lines. Third, it will provide a supplementary source of foreign exchange to which a member country may apply for the assistance necessary to enable it to maintain stable and unrestricted exchange relationships with other members.

During much of the period since the first world war, unstable exchange rates have seriously interfered with trade and the settlement of international balances. People who buy or sell abroad need to know today what their money will be worth tomorrow, and a year hence, in terms of their own currency.

Restrictions on payments, which have in the past been among the most serious obstacles in the way of international trade, take a number of forms. In some countries, importers are not permitted to purchase the dollars or pounds required to buy goods in the United States or England. In other countries, of which Germany before the war was an example, foreign trade was disrupted by the use of so-called multiple currencies. Germany also relied heavily on barter arrangements—"we will buy your coffee if you will accept our machine tools in payment." Barter is at the opposite end of the scale from freedom in international trade.

During the war, many new restrictions have been devised and employed for reasons of military necessity. Unless uniform standards can now be developed and generally adopted, the entire jungle of controls may be extended and intensified in the postwar period. We in the United States believe that the greatest possible freedom should be given to our own businessmen engaged in international trade. But we know that this freedom will be meaningless unless other countries accord an equal measure of freedom to their businessmen.

Exchange rates must be stable

The Fund proposal provides for stabilizing the value of world currencies. This is a subject that concerns every trading nation, the

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United States more than most. When an American sells abroad, he wants to be assured that the buyer's currency will have a constant value in terms of dollars. The reason is obvious. If, for example, he receives payment in Brazilian cruzeiros, the rate of exchange will determine the number of dollars he finally receives for a sale in Brazil. Even though the terms of the sale call for payment in dollars, which is not unlikely, the exporter will still be concerned with the stability of the cruzeiro, since a fluctuation in the dollar-cruzeiro exchange rate will alter the cost to the Brazilian buyer. Specifically, any depreciation of Brazilian currency raises the cruzeiro cost, possibly to a point where the Brazilian can no longer afford the purchase.

An American exporter, oddly enough, may be equally concerned with currency stability in other countries, Holland, for example, in which he neither sells nor expects to sell. This interest arises from the fact that producers in Holland compete for the same Brazilian market, and depreciation of the guilder would give the exporter in that country an edge over the American who, on the basis of efficiency in production and quality of product, might be able to hold his own in any market.

Under the Fund proposal, no member may resort to exchange depreciation simply to gain a competitive advantage in world markets. The proposal recognizes, however, that under certain conditions it may be necessary to change the value of a currency. For example, prices in a given country may remain relatively high while world prices generally decline. If so, the country's exports will drop off and its imports, over the short run, will tend to increase. This situation may be corrected by a downward adjustment of the exchange rate which, however, under the Fund proposal will have to be requested by the country in question and approved by other members of the world trading community.

Exchange Transactions Must Be Free

Among the more important provisions of the Fund proposal are those relating to the member's obligation to allow businessmen maximum freedom to conduct current transactions across boundary lines. This means more than simply allowing an Englishman who buys in America to pay the exporter in English pounds sterling. Since the American exporter cannot use pounds sterling to pay wages or buy raw materials in the United States, he must be assured that he can at any time readily convert a sterling balance in a London bank to dollar balances in his own bank. The problem is reversed in certain respects if it is agreed that the Englishman will pay in dollars. In that case, he should be able to buy a dollar draft on an American bank with an ordinary check drawn in terms of pounds, shillings, and pence against a London bank.

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So long as the financial transaction grows out of current business, the Fund proposal provides that a member country shall impose no restrictions either on the acquisition of foreign exchange or on the conversion of foreign balances into domestic currency.

Multiple currencies must be eliminated

During the inter-war years, the simultaneous use of several different kinds of currencies was one of the favorite tricks of the Axis nations. The value of special currencies was purely artificial, created and maintained to gain trade advantages by means which, to us, appeared unfair. Germany used a variety of special marks, some of which could be purchased at 3 or 4 to the dollar as against the official rate of 2½, to stimulate the export of goods for which the foreign demand otherwise would not have been great—wooden toys, aspirin tablets, or cheap manufactured goods. For such goods as cameras, optical lenses, and precision instruments she exacted all the traffic would bear in terms of foreign exchange. In certain instances, "bargain counter" marks could be bought from American owners of "frozen" German bank balances which could not be withdrawn in cash. It was the Germans who got the bargain, however, since by this device they were able to force merchandise upon customers who otherwise might have bought elsewhere. Discriminatory practices employed by Germany were variously applied from country to country, and even from firm to firm, and extended to foreigners exporting to as well as those buying from Germany.

Inasmuch as discriminatory practices obstruct the free flow of trade, members of the Fund must agree not to resort to their use.

Post-War Transition Period

It will not be easy for some countries to lift their exchange controls. Those ravaged by war will require time to revive the export industries upon which they ordinarily depend for supplies of foreign currencies. In these instances, the Fund will not require the immediate termination of all controls, but will expect every country to move in the direction of relaxation as rapidly as it can safely do so.

The Fund Must Have Resources

Stable exchange rates and freedom from exchange restrictions the world over cannot be achieved by hopeful resolutions alone. When a country agrees not to change the par value of its currency without Fund approval, nor to engage in restrictive exchange practices, it surrenders effective though blunt methods of singlehandedly adjusting its own economy to world conditions. Left to its own devices, a nation that finds its gold and foreign exchange resources inadequate to meet a temporary adverse balance of payments must,

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in self protection, resort to practices detrimental to world trade. No country is willing, however, to give up the right to depreciate its currency or restrict transactions in foreign currencies unless offered other means of securing results as good or better. The Fund must be prepared to help member countries maintain stable and free exchanges. Hence it must have at its disposal a sizable volume of liquid assets.

The assets of the International Monetary Fund will consist of currencies and gold to be subscribed by members in accordance with their quotas. Quotas for the original members, as determined at Bretton Woods, are stated in the Fund proposal. The gold portion of a member's subscription will be equal to 25 percent of its quota, or 10 percent of its net official holdings of gold and U. S. dollars, whichever is smaller. The member's currency subscription, equal to the remainder of its quota, will be in the form of a deposit to the account of the Fund at the member's central bank. A member may substitute a non-interest-bearing note, payable on demand, for that portion of its quota which, in the opinion of Fund authorities, is not required for working purposes.

At the start, the Fund will have total resources of $8.8 billion, of which the United States will subscribe $2.75 billion, the largest single share. Other large subscribers are England, Russia, China, and France.

Under carefully planned safeguards, the Fund will sell currencies in limited amounts to tide over a member temporarily in need of dollars, pounds, or francs, as the case may be. The Fund may use its gold resources to purchase any particular currency for which the demand is substantial.

For temporary use only

The Fund's resources are to be used to aid members in meeting a temporary adverse balance of payments on current international account. When a member's balance turns favorable, it will repurchase its own currency from the Fund with gold and foreign exchange. Thus the Fund's resources will be continually paid out and replenished. If a member's adverse balance is not temporary but chronic, it will have to undertake corrective measures. The Fund's resources are not to be used to finance a persistent deficit. Similarly, the Fund's resources are not to be used to accumulate foreign balances or to make permanent investments abroad.

Member countries are limited both as to the rate and amount of assistance they can get from the Fund. A member may not purchase foreign exchange with its own currency in a net amount exceeding 25 percent of its quota in any twelve-month period. Nor in general may a member over any period buy foreign exchange with

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its own currency in a net amount exceeding 100 percent of its quota plus the amount of its original gold contribution. Thus, if a country has a quota of $100 million, of which $75 million has been contributed in its own currency and $25 million in gold, it may purchase with its own currency a maximum of $25 million net of foreign exchange annually for five years, or a total of $125 million net, before reaching the normal limit of its use of the Fund's resources.

It should not be inferred, however, that a member has an absolute right to purchase any amount of foreign exchange from the Fund. A country known to have made improper use of its resources may be limited or entirely denied aid by the Fund. This is an important safeguard and a powerful sanction that may be employed to get members to adhere to Fund principles.

In addition to these quantitative limitations on the use of its resources and facilities, the Fund will impose charges that will increase both with the amount and the length of time a member uses resources acquired from the Fund.

Scarce currency

The Fund may occasionally be unable to meet all demands for one or more currencies. In that event, it may use gold to buy a scarce currency, or it may borrow from the member if the latter is willing to lend. If these remedies are inadequate, the Fund may formally declare a currency scarce and proceed to apportion its sales of that currency among members according to their relative needs. Moreover, members will be authorized to limit sales of the scarce currency.

The fact that the Fund may have to apportion its sales of a currency will not mean that the value of its assets has been impaired. Only the composition, not the gold value, will have changed, and the Fund will have the means wherewith gradually to replenish its supply of the scarce currency. In order to restore balance to the entire system of international payments, the Fund will suggest corrective measures to the member whose currency is scarce as well as to the members seeking the scarce currency.

Organization and Management

The International Monetary Fund will come into being when members subscribing 65 percent of its resources officially adopt the Agreement prepared at Bretton Woods. Each member country will then appoint a representative to serve on the Board of Governors, the body that will control the general policies of the Fund.

Responsibility for the operations of the Fund will be lodged in a board of 12 Executive Directors, of whom five will be appointed by the five members having the largest quotas—the United States, the United Kingdom, Russia, China, and France—two elected by the

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Latin-American republics, and the remaining five elected by all other members. The Executive Directors will appoint a Managing Director, who will be responsible for the day-to-day conduct of the Fund's business. The principal office of the Fund will be located in the country having the largest quota—the United States.

Voting power will in general be proportional to member quotas, every member being entitled to one vote for each $100,000 of its quota. However, as a device for enabling small countries to exercise some influence in Fund policies, every member starts out with 250 votes without regard to quota. A member's total votes thus computed will be slightly modified under certain circumstances. As the resources of the Fund are drawn upon, the voting strength of creditor members will increase while that of debtor members will decrease.

Cooperation vs. Isolation

The essence of the proposed International Monetary Fund is that it would substitute order and stability for the dog-eat-dog attitude that has in the past characterized international currency practices. Order and stability in exchange policies are objectives that can be attained not by a single country working alone but only by the united action of all of the 44 countries represented at Bretton Woods. Upon the attainment of these objectives hinges the realization of the ultimate goals of national policy—high levels of employment, rising standards of living, and economic development. In the shrunken world of tomorrow prosperity, like political security, lies not in isolation but in cooperation and mutual understanding.

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THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

What the Bank Will Do

The International Bank for Reconstruction and Development, like the International Monetary Fund, recognizes the need for worldwide cooperation in monetary and financial matters. Both aim at the balanced growth of trade as a means of achieving high levels of employment and rising standards of living. Each, however, will have its own separate function. The Fund will be concerned with orderly, stable exchange rates and freedom in exchange transactions; the Bank will be concerned with long-range productive international investment.

The Bank, therefore, will fill important needs in the postwar economies of all the 44 countries that assisted in preparing the Bretton Woods proposals.

Factories, dams, power plants, transportation systems, and public buildings in the countries ravaged by war have been shelled, bombed, and pillaged. Foreign capital will be needed to help replace this wealth. While it is fully recognized that the major portion of the reconstruction burden must be borne by the affected countries themselves, yet for many "seed corn" items of capital equipment they must look to their more fortunate neighbors.

There are also the long-standing needs of undeveloped areas inhabited by more than half of the world's population—particularly the Far East and some of the Latin-American Republics. To uncover and develop their resources, to make possible their full-scale participation in maintaining healthy economic and political conditions the world over, will require extensive investment of foreign capital.

A few countries will emerge from the war with heavy industries that can produce capital equipment for export. Since exports in substantial volume will depend on the revival of international investment, these countries have a vital interest in any plan that will place international investment on a high plane, supported by new standards and safeguards. Among the countries in this group, the United States ranks first in importance.

American investors took chances after the last war, and in the late 1920's and 1930's got caught in an epidemic of defaults. Although

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some would continue to purchase foreign securities offered in our markets, even without the Bank, many investors remember only too well what happened before. They realize that an investor should know something about the credit standing of the ultimate borrower; that a loan is much more likely to be repaid if it is employed for productive purposes; and that the lender should have means of checking up on the way in which his money is being used. Without these safeguards, foreign investment is a highly speculative business.

While the United States is concerned with the reconstruction and development of other countries for their sake, our principal interest in bringing about an expanded volume of American investment abroad arises out of concern for our own welfare. After the war, our economic policy will be aimed at full employment and full utilization of a greatly enlarged industrial plant. These objectives, however, cannot be realized unless we find new outlets for products of farm and factory—outlets that will be steady and profitable after war demands have dropped off.

International Investment is Essential

Ordinarily, an increase in exports can take place only if there is a corresponding increase in imports. Granting that a large volume of imports is desirable, the fact remains that the war-torn countries will require many years to rebuild their export industries. Moreover, they will require foreign capital to get under way. In the meanwhile, if our own exports are to expand, a large part of the expansion must take the form of American investment abroad. Stated another way, if foreigners are to buy a large volume of productive machinery and equipment in the United States in the immediate post-war period, American investors will have to lend part of the purchase money.

The investor, however, will want assurance that he is making a sound, remunerative investment. In providing this assurance, the International Bank for Reconstruction and Development will function in the following manner: It will determine the soundness of a project for which a loan is sought, particularly with respect to its capacity to enlarge a country's national income; it will secure the guarantee of the government of the country in which the project is to be located; and, finally, it will add its own guarantee. The risk of seeing that investors are fully protected, therefore, will fall not on the investors, nor even on any one country, but upon all of the 44 member countries. This is only fair, since all of the countries associated for the purpose of making the Bank possible will derive benefits from an expansion of international investment.

The Bank, under certain conditions, will also make direct loans. Its principal function, however, will be to stimulate private investment.

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The Bank's Guarantee

The Bank is not intended to supplant but to supplement the private capital market. Loans will be made, as they have been in the past, by private lenders who see an opportunity to make an advantageous investment in a foreign country. The Bank will support and encourage these loans through the usual investment channels.

When a firm in Brazil, for example, wishes to obtain American dollars with which to purchase equipment for an electric power project, it will send a representative to one of our underwriting houses to discuss terms. If the borrower is well known to American investors, the loan might be arranged without the Bank's assistance. But if the borrower is unknown, or if for some other reason funds cannot be raised on reasonable terms, the Bank may be requested to offer its guarantee. If, after a thorough investigation, the Bank is convinced that the proposed project conforms to all of the conditions and standards prescribed, it will guarantee the repayment of interest and principal.

In order that investors may always be assured that their own risks are reduced to a minimum, the total obligations assumed by the Bank may not exceed its unimpaired capital and other reserves.

Since all member countries will share the risks involved in expanding international investment, all must be in a position to benefit from the resulting increase in trade. The proceeds of a guaranteed loan, therefore, may be spent in any member country. The borrower in the above illustration may use all of the proceeds in this country, or in any other member country where the equipment sought can be purchased economically.

Further Safeguards for the Investing Public

In the past, loans were frequently made on the basis of inadequate information, and without supervision to prevent waste and misappropriation. The Bank will be in a position to see that borrowed funds are used only for the specific purpose for which they are intended. To private investors without the means of assuring themselves that their savings are being productively employed, this feature will be of inestimable value.

The private capital market will also benefit from the fact that the Bank may guarantee only loans that are made at reasonable rates of interest and bear schedules of repayment and other terms appropriate to the character of the project. These provisions will protect the borrower as well as the investor. Exorbitant charges imposed on foreign loans in the past have often proved too burdensome, and on occasion have led to economic and political disturbances that made repayment impossible. Lower rates, because of reduced risks, will facilitate the servicing of foreign loans.

The Bank's earnings will be utilized in such a manner as to afford

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the private investor additional security. Earnings will consist of interest received on direct loans, and commissions received on direct as well as guaranteed loans. The net income from interest may at the Bank's discretion be distributed to the member countries under conditions stipulated in the proposed Articles of Agreement. The income from commissions, however, must be held in liquid form, in a special reserve account, as a first line of defense against liabilities that might arise in case of default on loans made or guaranteed by the Bank.

Direct Lending Operations

Direct loans made by the Bank will be of two kinds. Of greater significance will be loans in which the Bank serves as intermediary between borrowers and lenders. The Bank may sell its own securities in the market of a member country, and in turn lend directly to the ultimate borrower. By this device the Bank will be able to consolidate numerous demands for small amounts of capital and to appeal to certain investors who might prefer to invest in securities issued by the Bank itself. The obligations thus incurred will be secured 100 percent, as will be the guaranteed loans, by the Bank's reserves and unimpaired capital.

The other form of direct loans will be made out of capital assets. The total volume of such loans, however, will be limited to 20 percent—and is likely to be less than 10 percent—of the Bank's subscribed capital. The standards for direct loans are the same as those for guaranteed loans. The projects to be financed must be productive; they must be endorsed by a member government; and the Bank will have to be convinced that private capital is not available on reasonable terms, even with its guarantee.

All loans and guaranties must have the consent of the country whose currency is involved. That is, both direct dollar loans made by the Bank and guaranteed loans floated in this country must have the approval of the United States Government.

Direct and guaranteed loans will for the most part be **additional** loans, over and above the private loans that would ordinarily be made, and will serve directly to increase the volume of international trade.

Source of the Bank's capital

The subscribed capital for the International Bank for Reconstruction and Development will be $9.1 billion. Of this amount, the United States, the largest single stockholder, will subscribe $3.175 billion. England will subscribe $1.3 billion, and all British Empire countries taken together, $2.375 billion. Russia, China, and France, in that order, will be the next largest subscribers.

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Because of the primary emphasis on the Bank's guaranteeing function, participating countries may never be required to pay more than a fraction of their respective subscriptions. In the first year of the Bank's operation, members will be required to pay in 10 percent, of which one-fifth will be in gold and the rest in currency. Another 10 percent will be subject to call at the convenience of the Bank. This 20 percent of total subscriptions will constitute the capital out of which the Bank may make direct loans.

The remaining 80 percent of the Bank's capital will be held as a surety fund—an uncalled reserve to back up the Bank's guaranties. Thus, out of a total of $9.1 billion of subscribed capital, the members will pay in only $1.82 billion, of which our share will be $635 million. No call will ever be made on a member government for any part of the surety fund unless a borrower defaults on a guaranteed loan, and then only if the Bank is unable to meet its obligations from reserves accumulated out of commission charges.

Membership

Membership in the Bank, in the first instance, is to be limited to countries that participated in the Bretton Woods conference and become members of the International Monetary Fund. Other countries may become members after they have been admitted to the Fund. Membership has been tied in this way because both institutions are designed to solve closely related problems. A country's adherence to the Fund will mean greater currency stability and the progressive removal of exchange restrictions, which will in turn reduce the risks of long-term investment. Furthermore, it is believed that only those nations that have demonstrated their willingness to cooperate in the improvement of basic world trade conditions should be permitted to participate in the operations of the International Bank for Reconstruction and Development.

A member may be compelled to withdraw from the Bank for failure to fulfill any of its obligations, and a member may on its own initiative withdraw at any time. While the withdrawing country will incur no further liabilities as a result of the Bank's operations, it will not be relieved of its share of the obligations assumed while it was a member.

Organization and Management

The Bank will come into existence when members subscribing 65 percent of its capital have formally approved both the Fund and Bank proposals. The management of the Bank will be under the general guidance of a Board of Governors, composed of a representative appointed by each member country. Each member will have 250 votes, plus one additional vote for each share of stock subscribed. The shares will have a par value of $100,000 each. Thus the United

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States, with a total of 31,750 shares, will have 32,000 votes out of a total of 100,750, or 32 percent of the total voting power.

In general, all policy issues will be decided by a majority of the votes cast. However, the United States will have veto power over proposals to increase the capital stock of the Bank and over all amendments.

Under the Board of Governors, and responsible for the conduct of the general operations of the Bank, will be a board of 12 Executive Directors. Five of the Directors will be appointed by the five members having the largest number of shares, and seven will be elected by the other members. The Executive Directors will select a President, who will organize a staff and, under the general guidance of the Executive Director, serve as the Bank's operating head.

The principal office of the Bank will be located in the United States, and at least one-half of the gold holdings of the Bank must initially be held here.

What the Bank Means to the United States

Once the Bank is in operation, the American investor can take advantage of foreign investment opportunities without assuming the risks that have had to be assumed in the past. Furthermore, since we are one of the few nations in a position to export substantial quantities of heavy materials in the immediate postwar period, a large proportion of the total loans sponsored by the Bank will necessarily be used for purchases in this country. The Bank, therefore, will help to create markets abroad for the output of our capital goods industries.

What the Fund and the Bank Mean to World Peace

Plans for the International Monetary Fund and the International Bank for Reconstruction and Development represent the cooperative effort of 44 United and Associated Nations. The plans are based on the conviction that stability and security in financial and commercial relationships will remove some of the important causes of war and at the same time help to open the way for increased trade and prosperity throughout the world.

The United States now, as never before, occupies a key position in world affairs. Whether we cooperate in maintaining the peace as we have in waging war will to a considerable extent shape the course of history for generations to come. Our acceptance and support of the Bretton Woods proposals, therefore, will be taken as a happy augury. It will mean to the rest of the world that instead of choosing economic isolation, which would inevitably lead to political isolation, we have determined to do our part toward the attainment of world peace and prosperity.

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