CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Substance of Remarks
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The proposed International Monetary Fund deals with only one segment of the future of international economic relations, namely, how the moneys of the several nations are to be related to each other. No problem would exist in this area if the economies of all countries started at a given point and all kept in step by developing at a uniform rate. Since this is not the case, we are confronted with a number of problems. Individuals differ as to the solutions they offer to these problems and there are a number of points on which reasonable men may differ.

I shall attempt to analyze the basic features of the International Monetary Fund and to indicate why, in my judgment, alternative approaches are inadequate. Almost every organization that has possibilities of achieving important constructive purposes is liable to abuse if it is perverted to improper ends. It is important in analyzing the Monetary Fund to consider the risks and the protections that are provided against them. This discussion will be based upon the "Joint Statement by Experts on the Establishment of an International Monetary Fund of the United and Associated Nations", dated April 21, 1944 and issued by the United States Treasury.

I

Profitable discussion may proceed only if we agree to an affirmative answer to the basic question: Shall we have international cooperation in the monetary sphere? Our real answer to this question will be demonstrated by the actions we take and not by the phrases we coin and express. It is important that we be perfectly frank with ourselves and with other nations with respect to our purposes and intentions.

1. Nature of the international monetary problem.

The nature of the international monetary problem may be illustrated with a simple example. Let us suppose that the pound sterling costs $5 in the foreign exchange market, but that it will buy only as much goods in England as $4 will buy in the United States. Clearly, it is not advantageous to anyone to pay $5 for a pound which will purchase only $4 worth of goods in the market. If these conditions exist, the pound and the dollar are in a condition of disequilibrium with respect to each other.

Equilibrium could be restored in three ways: first, by increasing the purchasing power of the pound; second, by decreasing the purchasing power of the dollar;

and third, by decreasing the foreign exchange price of the pound. The first two methods were used almost entirely before the first World War and were an integral part of the pre-war gold standard mechanism. England followed the method of increasing the purchasing power of the pound from 1925 to 1931. The result was deflation, labor unrest, and unemployment. Most nations of the world are determined not to adopt in the future policies necessary to remain on an international standard if such policies would result in unemployment.

During the 1930's, many nations adopted the other alternative of decreasing the foreign exchange value of their currency. It was a period marked by competitive exchange depreciation, exchange and trade controls, and many similar weapons of economic warfare, and may be characterized as anarchy run riot in international monetary affairs. Each country, attempting to protect itself, adopted practices that were detrimental to others and induced retaliatory measures. The net result was a cumulation of restrictive devices and strangulation of both international and national trade, markets, income, and employment.

Experiences during the inter-war periods, therefore, point to the conclusion that absolute stability in exchange rates is inappropriate when economic conditions and trends differ widely among the various nations, and that complete freedom in exchange rates, which means rapid and erratic changes, is also destructive of prosperity in all nations. On the positive side, these experiences demonstrate the need for international cooperation in the monetary sphere.

2. <u>What is the meaning of international cooperation in monetary affairs</u>?

International monetary cooperation involves:

(a) A genuine attempt on the part of all member countries cooperatively to establish proper initial rates of exchange based on the internal values of their currencies.

(b) A determination to maintain rates as stable as possible. This determination is subject to the achievement of appropriate national economic objectives, primarily the maintenance of a high level of productive employment.

(c) If changes in exchange rates are necessary to carry out national policies, to consider the international repercussions and to make the adjustments in consultation with other nations rather than unilaterally.

II

1. <u>How does the proposed International Monetary Fund deal with these problems</u>?

The proposed International Monetary Fund would deal only through governments, central banks, and similar fiscal agencies. It would not deal directly in the market. It is designed to meet temporary unbalances in international payments by providing resources (foreign exchange) to members in need of such resources. The Fund secures these resources from the subscriptions of member countries each of which subscribes a certain amount, called its quota, in gold and domestic currency.

Each member country is permitted to buy another's currency in exchange for its own from the Fund.

A primary objective of the Fund is "to promote exchange stability". It would assist countries that may be embarrassed temporarily by an unfavorable balance of payments to "tide over" this period of disequilibrium without resorting to exchange depreciation or deflationary measures. It is to meet the needs occasioned by temporary disequilibria that access to the Fund would play its most constructive role.

The Fund is not designed as a long-term lending institution. It could be useful in providing temporary assistance during periods in which long-term loans were being arranged. It could also be utilized to enable a country to obtain a "breathing space" during which it could readjust its economy to world conditions in an orderly manner. In the area of persistent, fundamental disequilibria, however, the Fund is designed to secure orderly changes in exchange rates when these are genuinely necessary. It does not follow that a country is inherently entitled to change its rate of exchange as it wishes. For example, an internationally irresponsible nation which has embarked upon a policy of deliberate inflation would not be entitled to change its rate even though the inflation resulted in unbalance.

2. What risks and difficulties are involved?

One of the major difficulties that may confront the Fund is that it is not always easy or even possible to distinguish whether accumulating deficits in the balance of international payments of a country are a result of temporary factors or of a condition of fundamental disequilibrium. A risk arises that members will use the Fund for improper purposes, namely, as a source of continuous credit in increasing amounts. In technical language, there is a danger that some currencies will become scarce in the Fund and others plentiful.

3. What protections are provided?

The Fund can be successful only if its resources are "available". This means that it possesses adequate supplies of all types of currencies that are being demanded. The Joint Statement contains a number of protections against the risks of improper use of the Fund and permits the insertion of additional safeguards in the final articles establishing the Fund. I should like to mention these protections. Obviously it is not the number, it is the nature of the protections that is important. The first protection is that no member country has any inherent unconditional right of access to the Fund. Access is conditioned upon a member country needing the currency of another in pursuance of the purposes and policies of the Fund. For example, a member may not use the resources of the Fund to meet a large or sustained outflow of capital. A second protection is that each member country in effect guarantees the gold value of its currency held by the Fund. If its currency depreciates in fact it is obliged to insure the Fund against any loss the Fund might sustain from such depreciation. A third protection is the limitations placed upon the extent to which a member may use the Fund without special approval. The maximum use is 25 per cent of its quota in any period of 12 months, or 200 per cent of its quota. Members are not absolutely prohibited from additional recourse to the Fund, but they could secure additional currencies of other members only on the basis of a positive showing. A fourth protection is that member countries whose gold holdings increase or are in excess of their quota are required to use part of their gold or convertible exchange rather than be permitted to rely exclusively on the Fund to secure currencies of other member countries or - what amounts to the same thing - that they shall use part of their gold holdings to repay the Fund.

In addition to these protections, the management has a number of powers to protect the Fund. At the extreme it may suspend a member from further use of the Fund's resources if the member is using them in a manner contrary to the purposes of the Fund. The power of suspension gives the Fund other powers short of suspension, such as limitations on the extent to which the member may use the Fund. This feature would seem to inhere in the practical operations of the Fund, but it might be well to clarify the provisions in the final document.

Other deterrents to the use of the Fund could be inserted in the final document as being in keeping with the basic purposes of the Joint Statement even though they are not contained in it. Such deterrents might include requirements of collateral from heavy users and charges levied against members making net use of the Fund. It would be helpful in maintaining the Fund's holdings of the several currencies in appropriate relations with each other - that is, preventing some currencies from becoming scarce and others too plentiful - if the scale of charges were varied on the basis of the net use of the Fund's resources and the length of time for which they were used. In other words, the more the currency of a member that the Fund held and the longer the Fund held it the higher the rate that the member would be charged. It should be repeated that a schedule of charges is not out of harmony with the principles of the Joint Statement but that the Statement itself contains no specific provisions on the point.

The effectiveness of many of the safeguards that have been mentioned depends upon the quality of the management of the Fund. Voting power in the management is to be related closely to the quotas; and the United States, which has the largest quota, would also have the largest voting power. Furthermore, although it doubtless will be the largest creditor nation in the post-war world, the United States probably will not be the only post-war creditor. Finally, if it is made clear that the supply of dollars, though large, is not inexhaustible, debtor countries may find it to their own interest not to be too generous with the distribution of dollars. The most powerful weapon possessed by the United States is the right of immediate withdrawal upon giving notice in writing and the necessity of settlement of reciprocal obligations. This power is so great that it should and would not be threatened or used without deep provocation; but it is a final, definitive power.

There is a very important protection of an entirely different type that the United States could establish; namely, a clear statement of our policy - the obligations we would assume and would not assume should we join the Fund. Lord Keynes established the policy of the United Kingdom in this respect in a statement before the House of Lords. A clear statement of American policy would be of great importance. It could aid in preventing later misunderstandings and recriminations. Our defense against possible eventual disagreements will certainly be strengthened if we state our position clearly now rather than permit our position to be established in the words of others.

An important point on which we should make our position clear is that concerning our policy if dollars should become a scarce currency. We should state now that we do not assume any obligation to provide additional dollars to the Fund. An appropriate statement could result in securing the support of debtors against improvident debtors. The interests of many who desire access to a common pool are quite different if the pool is unlimited than if it is large but limited. A statement of our position should contain also an announcement of our interest in stable exchange rates and that we do not view lightly cavalier changes in rates based on a mere announcement that they are "necessary to restore fundamental equilibrium."

III

1. Inadequacies of the key-country approach.

The most common alternative proposed for the International Monetary Fund is the so-called "key country" approach under which a few key countries, primarily the United Kingdom and the United States, would deal with their mutual problems in concert. Eventually other nations might join with them. Persons for whose judgment in these fields I have a very high regard favor this approach. Nevertheless in my judgment it is inadequate in a number of important particulars.

Experience demonstrates that financial crises do not originate exclusively in key countries though serious crises spread to them even though they originate elsewhere. An adequate machinery for international monetary cooperation should be inclusive enough to enable nations to "nip in the bud" - wherever it may be - developing difficulties. Such machinery should be of a permanent character rather than be created ad hoc after developments are already well under way or when they reach a key country.

The key country approach leads to or aggravates the development of rival blocs with key countries in the center and satellites moving in their orbit or under their influence. This tends to emphasize differences, to develop conflicts over satellites, and to build up similar destructive devices.

The inclusive approach also has the advantage of being based upon the rights and obligations of all members of the United and Associated Nations partnership. It builds on this partnership established in war in preference to ruling smaller nations out of the councils of the mighty. As a result it tends to maintain mutual understanding and national dignity rather than breed resentment.

The inclusive approach in no way minimizes the economic power of the key countries. This may be illustrated by describing the way in which one might expect initial exchange rates to be established. Certainly they would not be established by having the Minister of Finance of each member commune with the burning bush and emerge with some numbers that would be called exchange rates. The dollar-sterling rate is the crucial rate. The United States and the United Kingdom might therefore agree on a tentative rate. Other important nations might then discuss and agree tentatively as to rates for their countries appropriate to the dollar-sterling rate. Smaller nations could then, after discussion, place their rates in proper relation to these tentative rates. Finally, an over-all view by all countries would make possible the establishment of reasonable initial rates. Of course, there are many technical procedures and instruments that could be utilized to facilitate the process. Some countries, such as China, may be unable to establish appropriate rates.

These are important and crucial considerations that seem to me to be handled much more effectively through the inclusive approach than through the key-country approach.

2. Why do anything now?

There are always those who feel that "the present" is an inappropriate time to develop a program. Unfortunately, one cannot meet critical problems effectively by deferring until a crisis breaks. Some eighteen months have been spent by experts in many countries to bring the proposed Fund to its present status. An orderly procedure of establishing and changing rates of exchange can be of great help in the transition period itself even though the major purposes and objectives of the Fund are long run.

3. The Fund is not a panacea for post-war economic ills.

The Fund would operate only in a narrowly restricted field. It is not concerned with such imperative immediate and ultimate problems as relief, rehabilitation, reconstruction, and development. In a sense, the operation of the Fund would be analogous to the processes of oiling and greasing machinery - rather than to the functioning of the machinery itself.

Each of the United and Associated Nations has as a fundamental objective the creation of as full production and employment as is possible in its own country. This is the only practical way to improve the standard of living in the peace-loving nations. But this objective is only attainable if there is the fullest trade among the nations based on the interests of all. It cannot be achieved if military warfare is followed by economic warfare - if each country, to the disregard of the interests of other countries, battles solely for its own short-range economic interests. The unrestrained economic fighting of the 1930's points clearly to the conclusion that such economic warfare is neither in the best interests of the particular country or in the general interest of all countries. Unrestrained economic warfare, if allowed to continue in the future, will again disrupt production and jobs by destroying international trade and injuring national markets. It will undermine one of the foundation stones for a secure peace.