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INTERNATIONAL CURRENCY AND RESERVE PLANS

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Introduction

The hopeful plans for currency convertibility drawn up ten years ago at the Bretton Woods Conference have long been buried under the weight of the so-called dollar shortage which accompanied post-war reconstruction, the Korean crisis, and the first years of Western rearmament. The year 1953 witnessed, at long last, a fundamental and spectacular readjustment in the world's payments pattern. From gold and dollar deficits of nearly $11 billion in 1947, foreign countries moved gradually to an actual surplus, before aid, of nearly $1 billion in 1953. Their gold and dollar holdings—including United States aid receipts—dropped by nearly $6 billion in the three years 1946–1948, but have risen since by $8 billion, of which $2.6 billion was accumulated in 1953 alone.

National and international plans for currency convertibility have thus become again, for the first time in many years, a practical policy issue. The problem was raised here, on the initiative of the United Kingdom, a little more than a year ago, but the British suggestions were received with a surprising lack of enthusiasm in this country, in continental Europe, and even in Britain. The discussion of the plan soon revealed fundamental disagreements about the very meaning of convertibility under present economic and political conditions.

The Commission on Foreign Economic Policy, under the able chairmanship of Clarence B. Randall, devoted considerable attention to the issues involved. Its report,[1] issued last January, has done much to clarify the intimate relationship between the trade and the payments aspects of international convertibility. In the meantime the British plan was discussed further in the Organization for European Economic Cooperation (OEEC) and at the Commonwealth Conference in Sidney. Important steps toward the broadening of currency transferability and the relaxation of dollar restrictions have

[1] *Report to the President and the Congress,* Commission on Foreign Economic Policy, 1954.

also been taken in recent months by a number of major countries, particularly the United Kingdom, Germany, and the Netherlands.

The United States recession and the Congressional debate on the Randall report induced a wait-and-see attitude that slowed down the adoption of even more spectacular decisions, both nationally and internationally. There is little doubt, however, that such decisions will soon be forthcoming, and that they will be vitally influenced by the long-overdue clarification of United States policies.

The 1953 British Plan and the Randall Report

The plan presented by the British last spring rested essentially on a distinction between convertibility for residents and convertibility for nonresidents. The United Kingdom proposed to restore the convertibility of sterling earned in current transactions [2] by *nonresidents of the sterling area,* but to retain the right, for the United Kingdom as well as for other sterling area countries, to impose restrictions on all foreign transactions of their own residents. These restrictions could, of course, be imposed in order to limit the foreigners' sterling earnings and the drain on the area's gold and foreign exchange reserves which might attend the conversion of such earnings into nonsterling currencies, particularly dollars. They could, moreover, be imposed on a discriminatory or even bilateral basis to restrict imports from the countries presenting "excessive" demands for conversion and to favor imports from the countries which retained their earnings in sterling or made use of them to expand their purchases from the area itself. The proposal was made conditional upon a substantial liberalization of United States trade policies and the granting of large stabilization loans or lines of credit to the United Kingdom by the International Monetary Fund and by the United States.

The major criticism leveled against the plan, both here and abroad, was that its adoption might well stimulate a new wave of trade restrictions, discrimination, and bilateralism. The Randall report agreed with this criticism and indicated that the Commission "would deplore a merely formal convertibility maintained through

[2] The exclusion of convertibility for capital transactions has become generally accepted since Bretton Woods as a permanent feature of postwar convertibility plans. The practical wisdom and feasibility of this exclusion raises very complex issues which I shall make no attempt to discuss here. It might be noted, however, that the International Monetary Fund's example was not followed by the Agreement for a European Payments Union, which applies equally to all transactions among members, whether on current or capital account.

trade restrictions. It believes that the removal of restrictions upon trade and upon payments should go hand in hand." [3]

The continental European countries were particularly fearful of the implications of the British plans for the OEEC trade liberalization program and the European Payments Union. The Randall Commission expressed a similar concern about dismantling prematurely the most effective instrument for trade liberalization and currency transferability established so far: "The Union has achieved an impressive measure of success—above all, it has shown that freeing trade and freeing payment go hand in hand—and the Commission feels that it should not sponsor any measures that might wreck the Union before there is something better to put in its place." [4]

These criticisms may spring in part from an overpessimistic view of the external position of Britain and of the world's so-called "dollar shortage." [5] In the absence of heavy balance of payments pressures, the current trend toward trade liberalization might be expected to develop even without formal commitments, and to be strengthened further by the proposed measures for currency convertibility.

Yet the possibility of renewed balance of payments difficulties—whether in Britain or in other countries—cannot be excluded. Under such circumstances formal convertibility for nonresidents, unaccompanied by parallel commitments with respect to trade policy, might force a relapse into restrictions, discrimination, and bilateralism and destroy the progress already achieved toward a multilateral system of trade and payments.

After all, the proposed sterling convertibility already exists for residents of the United States and other "American account" countries. Sterling earnings accruing to such residents are freely convertible into dollars. Any other country that wishes to is also free to refuse payment in inconvertible sterling, and to demand gold or dollar payment for its exports. Most countries are deterred from doing so by the realization that such a policy would generally expose them to tighter restrictions on their exports to sterling area countries, similar to the restrictions now applied by these countries against imports from the dollar area. Sterling convertibility for nonresidents is certainly not regarded as true convertibility by the United States exporters who already "enjoy" this status, and it is certainly not sought by other countries' exporters to whom this "privilege" is now denied.

These considerations explain the coolness with which the British

[3] *Report to the President and the Congress*, p. 73.

[4] *Ibid.*, p. 74.

[5] See below, pp. 391 ff.

plan was received in continental Europe, in the United States, and even by a large sector of British opinion. While the plan has not been formally amended, numerous indications exist that opinion is gradually shifting, in Britain and elsewhere in Europe, toward a position fairly similar to that expressed in the Randall report. To be meaningful, convertibility must apply to trade as well as payments, to residents as well as nonresidents. This implies that progress can only be gradual and must depend on the fulfillment of certain prerequisites. "The Commission does . . . wish to emphasize its view that a strong internal economy, willing and able to control its money supply and its budget as safeguards against inflation, sufficiently mobile to make the best use of its resources, and able and willing to save in order to increase its productivity and improve its competitive position in world markets, is a prerequisite to convertibility; and that the attainment over time of these conditions should be the guide as to how rapidly full convertibility could safely be approached." [6]

These "prerequisites to convertibility" constitute, indeed, an awesome list, especially if they are viewed not only as once-and-for-all prerequisites for the *restoration* of convertibility, but also as permanent prerequisites for the *maintenance* of convertibility after it has been restored. Will any future lapse from internal strength automatically spell the collapse of convertibility for the country concerned? And how will the failure of some countries to reach or maintain convertibility affect the prospects for the achievement or preservation of *international* convertibility? "The Commission believes that the decisions, the methods, the timetable, and the responsibility for introducing currency convertibility should rest on the countries concerned. It recognizes, however, that currency convertibility must be examined in the light of the policies pursued by other countries, particularly the United States." [7] The Commission thought also that the restoration of convertibility by Britain would greatly facilitate—or even be necessary for—its restoration by other countries, and would in turn be greatly eased "if some other of the major trading countries [were] able to make their currencies convertible simultaneously with sterling." [8]

The Randall report thus seems to contemplate the unilateral restoration of convertibility by each country, acting in isolation, but also recognizes the interdependence among the various countries' deci-

[6] *Report to the President and the Congress,* p. 73.
[7] *Ibid.,* pp. 72–73.
[8] *Ibid.,* p. 74.

sions and policies, particularly those of the United States, the United Kingdom, and other major trading countries. The recognition of this interdependence is in happy contrast with the naïve theory which still prevails in academic and business circles, and which long dominated the United States Treasury thinking, i.e. that convertibility merely depends on each country's "setting its own house in order" by stopping inflation, readjusting its exchange rate, abolishing trade and exchange controls, and requiring full gold or convertible currency settlement for its exports and other external transactions. Even a country as strong internally and externally as Switzerland still feels unable to adopt such a prescription and run the risk of generalized discrimination against its exports.

International currency convertibility cannot be restored and—even more important—maintained without the active participation and cooperation of the major trading countries. While this participation and cooperation could largely be taken for granted in the nineteenth century, they cannot be ensured today by mere unilateral decisions, but require at least a minimum of collective organization and mutual commitments.

Before discussing the nature of these commitments, we must clarify the meaning of currency convertibility as an international policy objective. We shall then discover that the necessary commitments are far less formidable than the "convertibility prerequisites" which are listed in the Randall report, and which, indeed, no international agreement could ever be relied upon to enforce effectively.

Toward a Definition of "Workable" Convertibility

Currency convertibility used to be defined by the maintenance of a fixed parity or exchange rate with relation to gold or gold-convertible currencies. But the modern proponents of convertibility argue in favor of flexible or "floating" exchange rates as against fixed or "pegged" rates. The reason for this shift is, of course, obvious. The fixity of exchange rates becomes largely illusory if it is preserved only through trade or exchange restrictions which control arbitrarily the access of traders to foreign exchange for each category of transactions, and may deny them the right to purchase it at any rate whatsoever. Exchange stability has little or no meaning if it is not based on exchange freedom. The latter was taken for granted in all traditional definitions of convertibility. True currency inconvertibility—as distinct from instability of exchange rates—is a relatively

modern phenomenon. It might be noted, for instance, that European currencies remained convertible throughout the 1920's, even though at a fluctuating exchange rate.

Here again, the Randall report marks definite progress over previous policies, and particularly over the exaggerated emphasis placed on exchange rate stability at Bretton Woods. The Commission expressed itself as "sympathetic to the concept of a 'floating rate', which provides alternative methods of meeting trade and exchange pressures." [9]

This seems to leave us with the elimination of trade and exchange restrictions as the modern definition of convertibility. The question arises at once whether any full elimination of such restrictions is conceivable within a foreseeable future, and whether such liberalization can realistically be confined to direct, quantitative restrictions while leaving tariff restrictions to the full discretion of each individual country. There are undoubtedly very important differences between tariff restrictions and other trade or exchange restrictions. Most of these differences relate, however, to the *domestic* impact of such measures upon income and money flows. From the point of view of their *international* impact, the differences between tariffs and trade controls are not so fundamental as to justify the definition of convertibility in terms of a full elimination of the latter without any concern for the first. High and unstable tariff levels can indeed be as damaging to international trade as moderate, nondiscriminatory systems of import or exchange controls, or more so.

Shall we therefore be pushed into a definition of convertibility which equates it to the old free trade ideal of classical economists? In this case, progress will indeed have to be gradual, and full convertibility is unlikely to reward our efforts or even those of our children and grandchildren.

Clarity of thought and effectiveness of policy both require a less ambitious definition of immediate convertibility goals. Such a definition can be found in the restoration of a *multilateral system of trade and payments*, rather than in the removal of all protection for domestic production against imports from abroad. This was indeed the meaning of nineteenth-century convertibility, which accommodated itself to varying degrees of national protection. The major differences between these age-old techniques of protection and modern inconvertibility techniques lie in the fact that the former extended protection only to the national producers and only within the protecting country's boundaries, while the latter discriminate in favor

[9] *Ibid.*, p. 73.

of certain exporting countries at the expense of others, and try to protect domestic producers not only within the country's boundaries but in all foreign markets as well. Once adopted by a major country, such techniques inevitably spread from trading partner to trading partner, each country trying to secure special advantages to itself or being forced at least to defend its exporters against the discriminatory actions of others. International trade is then forced more and more into the strait jacket of bilateral negotiations, which push all considerations of price or quality competition and the underlying pattern of comparative costs and advantages into the background.

The key to "workable" convertibility is not free trade—desirable as this would be—but the maintenance of full competition in third markets. MacDougall's study of United States and United Kingdom exports in 1937 showed ample verification for the classical theory of comparative costs, but found that it depended essentially on *third market competition* rather than on direct trade between the two countries. "Before the war, American weekly wages in manufacturing were roughly double the British, and we find that, when American output per worker was more than twice the British, the United States had in general the bulk of the export market, while for the products where it was less than twice as high the bulk of the market was held by Britain. . . . But while in the normal text-book examples the exports of each country go to each other, the great bulk of the exports of the United States and the United Kingdom in 1937 went to third countries—more than 95 per cent of British exports of all our sample products but three, more than 95 per cent of American exports of all the products but six. It is true that each country was nearly always a net exporter to the other of products in which it had a comparative advantage, but this is of limited interest, since trade between them was in general a negligible proportion of their total consumption." [10]

Thus the preservation—or restoration—of traditional competitive forces in international trade depends essentially on the equal access of all foreign exporters to each national market, rather than on the elimination of all protection for domestic producers within a country's own territory. The latter objective has never been achieved, and can hardly be expected ever to be fully achieved without a political as well as economic merger among the countries concerned. Equal

[10] G. D. A. MacDougall, "British and American Exports: A Study Suggested by the Theory of Comparative Costs," Part I, *Economic Journal*, December 1951, pp. 697–724, particularly pp. 697–699. See also below, Table 3, col. 4.

access to third markets has always constituted the bulk and the core of international competition.

Convertibility is not incompatible, therefore, with a certain amount of protection and restrictions. The past is, in this case, a guide to the future. The restoration of convertibility depends essentially on the elimination of discrimination and bilateralism—rather than of *over-all* protection or restrictions—from the trade and payments mechanism. This implies: (1) the ability of country A to use its earnings from countries B, C, D, etc., to settle its deficits with countries X, Y, Z, etc., i.e. full currency transferability; (2) the absence of bilateral or discriminatory trade techniques designed to shift trade artificially from low cost exporters to high cost exporters, thus distorting normal competitive forces not only between domestic and foreign producers, but in all third markets as well.[11]

The two problems are largely inseparable, because payments and trade techniques reinforce one another in this respect and can often be used almost interchangeably to achieve the same result.

The weakness of the International Monetary Fund springs in large part from the artificial separation of these two problems—one of which was entrusted to the Fund, and the other to the General Agreements on Tariff and Trade—but even more from basic defects of the Fund's machinery for dealing with currency transferability. Countries may borrow from the Fund, but they cannot use the Fund to convert their earnings from one country into the currency needed to settle their deficit with another. Moreover, the Fund has in practice made little or no attempt to distinguish between exchange restrictions and discrimination. Organized discrimination against a "scarce currency" is theoretically provided for under Article VII of the Fund Agreement, but this provision has never been tested by the Fund. On the other hand, Fund members have so far retained the right to currency discrimination—against weak as well as against hard currencies—under Article XIV of the Agreement. Similar discrimination is also contemplated as a permanent feature of the Agreement under Article VIII, although its use under this article would be subject to Fund approval.

In contrast, the remarkable success achieved by the European Payments Union is largely explainable by its comprehensive approach to the problem, encompassing full multilateralism both in trade—nondiscrimination—and in payments—currency transferability. This multilateralism, however, is confined to the relationships

[11] This definition is very close to that proposed in *Staff Papers,* Commission on Foreign Economic Policy, 1954, pp. 467–468.

among member countries, and does not cover their trade and payments with other countries and particularly with the United States. Partial convertibility with the United States dollar is provided in EPU settlements, but each country is left free to regulate as it wishes its trade and payments with nonmember countries.[12]

Most of the difficulties which the EPU has had to meet in its four years of operation, and most of the objections raised against it, are closely related to these regional limitations of the Agreement. These were, however, unavoidable at the time the Agreement was negotiated. While they are probably unnecessary and even harmful under present conditions, their elimination might prove dangerous in the event of a renewed dollar scarcity, as it might then contribute to the unnecessary spread of deflationary forces and to an ultimate relapse into generalized bilateralism.

The Prerequisites of Convertibility

Convertibility has been defined above as the absence of discrimination, and particularly of discriminatory bilateral action, with respect to both trade and payments. While indispensable to the maintenance of international competition, such a system is also subject to a major defect. It tends to spread to the world at large any deflationary pressures arising from an economic depression or from trade restrictionism in one of the major trading centers. If each of the countries most heavily and directly affected by the decline in this center's imports adopts *nondiscriminatory* policies—internal deflation, currency devaluation, over-all trade or exchange restrictions, etc.—to restore equilibrium in its balance of payments, it will affect unfavorably the balance of payments of other countries. These may, in turn, be compelled to adopt similar policies—or to reinforce them—thus contributing to the spiraling of deflation, devaluation, or restrictions. This process will continue until the first country's surplus is ultimately eliminated, but will involve a multiple restriction of world trade—or an extensive devaluation of currencies—which might have been avoided by direct and systematic discrimination against the surplus country alone. For this alternative to be successful, however, discrimination by the deficit countries must be directed exclusively against the *over-all* creditor country, rather than against

[12] Payments to and from nonmember countries of the sterling area are, however, channeled through the United Kingdom's account, and are subject to the same settlement rules as are applicable among members. The same applies also to all other sterling transfers.

the countries in *bilateral* surplus with them, since such bilateral creditors may themselves be in over-all deficit rather than in over-all surplus. If discrimination is left to the discretion of each individual country, acting in isolation, it will inevitably take the form of bilateral discrimination and involve even worse distortions—and, probably, a greater contraction—of world trade.[13]

This was recognized in the "scarce currency" clause of the International Monetary Fund, but the practical implementation of such a clause would raise enormous difficulties. Public opinion in the scarce currency country is likely to pay little heed to the intricate economics of the problem and to react violently against the ganging up of other nations against its exports. The danger of retaliatory action will deter many countries from participating in systematized discrimination. This is all the more likely because such discrimination might involve the imposition of tight restrictions against essential imports from the scarce currency country while unessential imports from other countries continue to be imported freely. Countries can hardly be expected to sacrifice their own national interests in this manner for the sake of an abstract concept of international equilibrium. Certainly, the exact degree of implementation required from each participant would give rise to endless debate and controversies.

A more practical approach to the scarce currency problem lies in the extension of nondiscrimination over the widest possible area, on the basis of mutual agreements and commitments, rather than in any international quarantine of the major creditor country. The EPU experience reveals very clearly the type of commitments necessary for the effective functioning of a multilateral trading area. The creditor countries must facilitate the adoption by the debtors of *nondiscriminatory* readjustment policies:

1. By not hampering such policies through unnecessary trade or exchange restrictions over their own imports (such liberalization commitments were accepted by all EPU members, but were exceeded in practice by the surplus countries)
2. By providing fractional financing to cushion moderate deficits

[13] An abundant literature has grown up around this problem and its applicability to the so-called "dollar shortage." See, in particular:

E. M. Bernstein, "Scarce Currencies and the International Monetary Fund," *Journal of Political Economy*, March 1945, pp. 1–14

Ragnar Frisch, "On the Need for Forecasting a Multilateral Balance of Payments," *American Economic Review*, September 1947, pp. 535–551

John H. Williams, *Trade Not Aid: A Program for World Stability*, Harvard University Press, 1953

of other members with inadequate reserves, thus allowing them to ride out temporary fluctuations in their balance of payments, or to wait for the effect of more slowly acting fiscal or monetary readjustment policies

3. By avoiding retaliatory action against countries which may be compelled to restore restrictions temporarily because of heavier deficits, provided that:
   a. Such restrictions remain nondiscriminatory as among members
   b. The restricting country submits its case to full discussion by the competent organs of the OEEC, with discussion to cover not only the external measures adopted, but the whole range of monetary, fiscal, and economic policies of the country concerned

From Regional Convertibility to International Convertibility

Such a close type of cooperation is hardly feasible on a world-wide basis. It is possible only among countries which are highly interdependent (exports to the EPU area account for nearly three-fourths of member countries' exports), keenly conscious of their interdependence, and able to understand each other's problems and policies. These factors—different in degree, but not in kind, from those underlying a fuller political union—explain the success of, and justify the need for, regional cooperation in trade and payments. The maintenance of freer trade among members constitutes, of course, a form of discrimination. Such discrimination, however, rooted in mutual commitments of the type described above, may be as justified by its broad political and economic results as the discrimination against imports from abroad, and in favor of interregional imports, implicit in present boundaries between nations. The progressive elimination in the nineteenth century of internal taxes on the movement of goods between cities or provinces of the same country presents a hopeful pattern for freer movement of trade among countries ready to accept mutual trade and financial commitments limiting the untrammeled use of their economic sovereignty.

Under the inflationary strains of postwar reconstruction, the sterling area and EPU arrangements provided a practical alternative, not to a better and wider system of international convertibility, but to the infinitely worse alternative of generalized bilateralism in trade and payments. They could not, however, provide a satisfactory answer to the fundamental disequilibria then prevailing between these regions and the outside world and, particularly, to their trade and

payments problems with the dollar area. In the sterling area the responsibility for handling these problems centered largely on the United Kingdom, through the administration of the dollar pool and the setting up of different types of sterling accounts—American and Canadian accounts, transferable accounts, resident sterling accounts, bilateral accounts, etc.—subject to different privileges and limitations as to their transferability in payments. In the EPU no such centralization was attempted, and each country was left free to handle its own trade and payments with nonmember countries. On the other hand—and in contrast to the exclusive use of sterling in settlement among sterling area countries—the partial gold or dollar payments involved in EPU settlements established a direct link between the positions of individual EPU countries within and outside the EPU area.

Such a system may tend to stimulate discrimination against an outside scarce currency, but also tends—contrary to a widely spread misconception—to eliminate discrimination if no such scarcity exists.

The stimulus to discrimination arises from both the payments and the trade rules governing the system. EPU creditors are forced to liberalize imports from other EPU members, but are left free to maintain—or liberalize—restrictions on imports from the outside. Since, however, they receive also partial gold or dollar payment for their EPU surpluses, they may be unable to finance large deficits with nonmembers requiring 100 per cent gold or dollar settlements. Even if their gold and dollar position enables them to do so, they may be alarmed by the continued growth of their EPU lending and adopt restrictions on outside imports, in order to force their residents to shift their purchases to EPU sources and thus reduce their rate of lending to the Union.

Debtor countries, on the other hand, will normally prefer to incur their deficits with the Union, rather than with other countries, since deficits with the Union require only partial gold and dollar payment and are, for the remainder, financed by EPU credits. These credits, however, are limited in size. When a country remains persistently in deficit with the Union, its ratio of gold to credit settlements rises steadily until the point of 100 per cent gold settlements is reached. When this occurs, the financial stimulus to discrimination disappears, and the deficit country becomes increasingly reluctant to admit freely less essential, or costlier, imports from EPU sources while continuing to restrict severely more essential or cheaper imports from the outside. On the other hand, such persistent deficits on the part of some members are reflected in persistent surpluses on the

part of others. The creditors become increasingly reluctant to continue to extend larger and larger credits beyond their quotas. Since the Union, under these circumstances, is receiving 100 per cent gold settlements from the extreme debtors, its convertible resources tend to increase and to enable it to grant additional payments to the creditors either through a larger ratio of gold to credit settlements, or through some amortization of their previously accumulated claims.

The experience of the EPU so far confirms these theoretical deductions. Of the $1,350 million of EPU credits initially available to them, present members have used about $1,150 million and have therefore only about $200 million in all left available. For many months, France, Turkey, and Greece have been subject to 100 per cent gold settlements and have claimed release from their trade liberalization commitments. Restrictions were also restored by the United Kingdom as long as its quota was exhausted or remained perilously close to exhaustion, and it will be remembered that, for a while, the United Kingdom also accepted sterling payment for dollar commodities bought through London. On the creditors' side, substantial amortization payments were granted to Belgium and Portugal in June 1952, and proposals now under discussion envisage both an increase in gold settlements beyond quotas and the regular amortization of long-outstanding claims.

This normal evolution of the Union toward convertible settlements and nondiscrimination can be held in check, in the long run, only by a severe and generalized dollar scarcity. When this exists, most members will be anxious to preserve their exports against the tighter restrictions applied to dollar trade, and will recognize that this can be done only through mutual trade liberalization and the limited convertibility of intra-EPU settlements. When, however, the dollar position of a majority of members becomes more comfortable, the maintenance of discriminatory trade and payment rules is increasingly regarded not only as contrary to their own selfish interests, but also as unnecessary from the point of view of the group as a whole. It should be noted, for instance, that the EPU management has always prodded excessive debtors to readjust their deficits through monetary and fiscal policies. Exchange readjustments have sometimes been hinted at too, but with a discretion imposed by common sense as well as by the desire to avoid any conflict of jurisdiction with the International Monetary Fund. These pressures had a considerable influence on member countries' policies, particularly in the case of Germany and the Netherlands. They were reinforced in the first case by a special loan negotiated on the basis of an

agreed readjustment program, but at no time has the EPU seriously entertained any proposals for further credit extensions to deficit countries which did not take adequate steps to readjust their balance of payments.

We may conclude, therefore, that while *formal* commitments to nondiscrimination and currency transferability are most likely to prove feasible on the basis of regional cooperation, such arrangements will tend *de facto* toward world-wide nondiscrimination and convertibility, except when discrimination against a "scarce currency" becomes the only alternative to the international spread of deflation or of bilateralism.

Even in the latter case the maintenance of currency transferability and nondiscrimination among member countries preserves powerful competitive pressures upon the higher cost countries. It prevents them from seeking in bilateral trade and payments agreements an escape from basic economic readjustments. They can no longer extract from their creditors bilateral import credits or discrimination in favor of their exports. Moreover, the gradual liberalization of trade restrictions among members opens each market to the competition of the lower cost producers in the area, and fundamentally influences the readjustment of national price and cost patterns, indispensable to further progress toward world-wide, rather than merely regional, convertibility. There is little doubt that full competition with Belgian, Swiss, German, and other exporters over the whole EPU area has exercised upon higher cost producers a pressure equivalent, or nearly equivalent, in most cases to that of competition from nonmember countries.

This is confirmed by the near elimination of currency discounts and gold premiums in the European free markets, and by the ease with which major steps toward trade liberalization and broader currency transferability have been absorbed in recent months. The abolition of rationing, the reopening of international commodity and gold markets in London, the merging of practically all nonresident sterling accounts—outside the dollar area—into a single transferable account system, the adoption of a similar system for Deutsche mark accounts, the liberalization of many categories of dollar imports and other transactions in Germany and the Netherlands, etc., have already narrowed considerably the gap between regional and international convertibility. There is every indication today that the remainder of the gap could be bridged if some method could be found to assuage current fears about the existence, or future resurgence, of a world-wide dollar scarcity.

International Inflation and the Dollar Shortage

A "currency scarcity" condition—i.e. the tendency for many countries to incur convergent deficits toward a single "scarce currency" country—may emerge from many different causes. A number of writers have popularized the view that a higher rate of technical advance in the United States tends to create a chronic dollar shortage. The *possibility* of such a link cannot be flatly denied on purely logical grounds. The *demonstration* of its inevitability or probability depends, however, on highly special assumptions as to the exact nature of such productivity advances, and as to their impact on prices and money wages, terms of trade, the income elasticity of import demand, etc. It would not be difficult to construct extremely plausible models of United States advances in productivity whose impact would be to reduce, rather than increase, the balance of payments surpluses of the United States, without exercising any generalized deflationary pressures on foreign prices, export levels, economic activity, or employment.

TABLE 1

Estimated Gold Reserves and Dollar Holdings of Foreign Countries
(*dollars in billions*)

					1953 AS PER CENT OF:		
	1928	*1938*	*1948*	*1953*	*1928*	*1938*	*1948*
Continental Western Europe	*$4.8*	*$ 7.3*	*$ 5.8*	*$10.1*	*207%*	*138%*	*172%*
France	2.0	3.0	.8	1.1	52	35	132
Switzerland	.2	.9	1.9	2.1	1,080	230	112
Other	2.6	3.4	3.1	6.9	307	177	220
Sterling area	1.4	3.9	2.9	4.0	288	104	138
Canada	.4	.4	1.2	2.4	580	610	198
Latin America	1.1	.9	2.7	3.6	320	380	132
All other foreign countries	1.0	1.3	2.3	2.9	300	225	126
International organizations	...	...	3.4	3.3			99
Total outside United States	$8.7	$13.8	$18.4	$26.4	300%	190%	143%

Details may not add to totals because of rounding.
Source: *Federal Reserve Bulletin*, March 1954, p. 245.

A dollar shortage undoubtedly tends to emerge, however, when the United States economy develops lesser inflationary pressures, or greater deflationary pressures, than the rest of the world. This timeworn doctrine still seems to me sufficient to explain the tendency of European countries to run into heavy dollar deficits during a period of intense inflationary pressures associated with war financing

and the reconstruction of war damage, or in the course of a world depression marked by steeper price and income deflation in the United States than in most other industrial countries.

I find it extremely difficult, however, to discover any chronic dollar shortage in the current pattern of world payments. Foreign countries' gold reserves and dollar holdings are estimated to have increased by about $8 billion in the last five years and by $2.6 billion in the year 1953 alone. Table 1 shows that foreign gold and dollar holdings are far higher today than in any previous period. While still inferior to 1938 levels in real purchasing power, they are also probably far better distributed with relation to most countries' import levels and export instability than at any time in the recorded past.

The fears of a dollar shortage spring from the special factors underlying the present pattern of the balance of payments of the world with the United States, and particularly from:

1. The dependence of foreign countries' current dollar earnings on large and "abnormal" United States expenditures for foreign aid and military procurement overseas
2. The expected increase in their dollar needs if present restrictions and discrimination on dollar transactions were eliminated by the restoration of convertibility
3. The possible impact of a United States depression on their levels of reserves, foreign trade, and economic activity in general

THE ROLE OF "ABNORMAL" UNITED STATES EXPENDITURES ABROAD

The 1953 accumulation of gold and dollars by foreign countries far exceeds their total receipts of United States aid.[14] Even the further curtailment of United States military disbursements overseas would leave Western Europe and the Western Hemisphere in approximate gold and dollar equilibrium, but would leave the rest of the world with a deficit of about $1.7 billion (see Table 2).

Adding to this an estimated $.6 billion for stockpiling purchases, the Randall report discerns in these figures a "concealed dollar gap of some $2 billion to $3 billion annually, which would be increased if there were a change in the economic situation, such as a recession

[14] Other than so-called military-end-use items contributed in kind by the United States under military aid programs. This form of aid and the corresponding United States exports have been excluded throughout from the data presented in this paper, since there is every reason to assume that such items would not be imported in significant quantities by foreign countries under circumstances permitting the cessation of military aid programs.

TABLE 2

Gold and Dollar Transactions of Foreign Countries in 1953

(*millions of dollars*)

	World	*Continental Western Europe*	*Sterling Area*	*Canada*	*Latin America*	*Other Countries*	*International Organizations*
Estimated increase in gold reserves and dollar holdings	2,720	1,670	860	–20	250	–130	90
Through receipts of U.S. aid, Exclusive of Military End Items	1,770	840	400	. . .	20	420	90
Through all other transactions	950	840	450	–20	230	–540	. . .
U.S. military purchases of goods and services overseas	2,570	990	280	150	20	1,130	. . .
Civilian transactions	–1,620	–150	170	–170	210	–1,670	. . .
Net outflow of U.S. capital	*590*	*–260*	*90*	*350*	*220*	*140*	*60*
Government	220	–110	. . .	. . .	340	–20	. . .
Private	370	–150	80	350	–120	160	60
Multilateral transfers and errors and omissions	*160*	*200*	*110*	*510*	*110*	*–730*	*–40*
Recorded in U.S. transactions	–270	100	–220	410	130	–630	–60
Other	430	100	320	100	–20	–90	20
Current account with the U.S.	*–2,370*	*–80*	*–30*	*–1,030*	*–130*	*–1,090*	*–20*
Receipts	14,680	3,220	2,520	3,020	4,230	1,650	40
Expenditures	17,050	3,300	2,550	4,050	4,360	2,740	60

Source: Data are primarily derived from official estimates of the United States balance of payments, as presented by Walther Lederer on pages 22–23 of the March 1954 issue of the *Survey of Current Business* (Dept. of Commerce). Differences between total changes in estimated gold holdings as reported in the *Federal Reserve Bulletin,* March 1954, p. 240 and the United States gold sales and purchases have been entered under "other multilateral transfers" and added to the reported United States balance on foreign capital and gold to arrive at the "Estimated increase in gold reserves and dollar holdings." Unilateral transfers other than aid have been included in "current account receipts."

here or a deterioration in Western Europe's terms of trade. On the other hand, it should be recognized that major parts of our 'extraordinary' expenditures abroad are connected with our defense effort, and that the Western European countries' own defense programs affect adversely their trade position, by increasing their essential imports and by absorbing resources that would otherwise be available for expanding their exports."[15]

The constant references to Western Europe in these comments suggest that the Commission was not aware that its "concealed dollar gap" concentrates almost entirely on the Far Eastern countries—particularly Japan—whose economies have been disrupted by military events and geared to a high rate of United States military procurement. It is, of course, obvious that these countries are not now accumulating gold and dollar *surpluses* equal to whatever the United States army spends there for procurement of goods and services, plus the amounts of reconstruction or defense support aid to Korea, Nationalist China, etc. This becomes a "concealed dollar gap," however, only if one assumes that such expenditures are likely to be completely eliminated in time, without any corresponding offsets in foreign countries' dollar imports or exports.

Both assumptions would be extremely unrealistic. United States military disbursements overseas are still rising now and will at best taper off gradually, with little or no probability that they will fall to zero in the foreseeable future. Moreover, such tapering off would simultaneously release for consumption, investment, or exports the resources otherwise absorbed in the production of the goods and services contributed under these programs. This trend would be further reinforced by the decline in foreign countries' own military budgets that would be likely under such circumstances.

Absorption of these resources into civilian production will, of course, require difficult economic readjustments. For Western Europe as a whole, the problem is more likely to center on the maintenance of domestic activity and employment than on the balance of payments itself, since its current gold and dollar accumulation is already as large as the total of aid and military disbursements receipts (see Table 2 above). In the Far East, however, the readjustments will bear more heavily on the need to reduce imports or increase exports, and these readjustments might spread to other areas and recreate generalized balance of payments difficulties with the United States if the decline in United States military expendi-

[15] *Report to the President and the Congress,* p. 5.

tures were not offset in part by some increase in United States commercial imports or capital exports. Given the present rate of gold and dollar accumulation by foreign countries ($2.7 billion), however, moderate changes in United States export and import levels would be sufficient to absorb any foreseeable reduction in United States aid and military disbursements.

THE ROLE OF DOLLAR DISCRIMINATION

The removal of discrimination against dollar trade constitutes a second factor of fear and uncertainty in the progress toward convertibility. The Randall Commission *Staff Papers* report that "guesses at the magnitude of the suppressed dollar demand have ranged between $1 billion and $3 billion a year; the true figure at present is probably much closer to the former than to the latter." [16] I am inclined to reduce even further the estimates of the real quantitative impact of dollar discrimination upon the balance of payments.

First of all, we must not forget that more than half of the United States exports flow to such areas as Canada, Central America, the Caribbean Islands, the northern coast of South America, Japan, the Philippines, etc., which either have no exchange controls at all (Canada and most of Central America) or which have no reason to apply discriminatory controls against dollar goods as such.

Second, the proportion of United States and Canadian exports in total imports of the rest of the world is now already far larger than before the war. This is true not only for the world at large, but for all individual areas as well, with the single exception of the sterling area. The proportion is about one-third larger than in 1937 for Latin American and continental EPU countries, and 20 per cent larger for the countries outside the sterling area, continental EPU, and Western Hemisphere.

Third, while the elimination of dollar discrimination will tend toward an expansion of United States exports, two other factors are now acting in the opposite direction. The reduction in foreign aid eliminates some elements of discrimination *in favor of* United States shipping and commodities previously purchased under the ECA, MSA, or FOA procurement authorizations. Moreover, the recovery of production and the abatement of inflationary forces abroad reduce foreign demand for other United States goods imported in abnormal quantities in earlier years. It should be noted that the proportion of United States and Canadian goods in the

[16] *Staff Papers*, p. 18.

total imports of Western Europe and the sterling area has declined substantially over the past year, in spite of greater dollar availabilities and of the trend toward a relaxation of dollar discrimination abroad. The continuation of this trend, in a noninflationary environment, might well result primarily in price readjustments by soft currency exporters, rather than in any large diversion in the pattern of trade. This would be all the more likely if progress toward nondiscrimination were undertaken simultaneously by all major trading countries rather than by one or a few countries alone.

For all these reasons the relaxation of trade and currency discrimination against dollar goods is likely to have a much more moderate impact on the dollar position of foreign countries than is generally feared. In any case, the relatively small order of magnitude of its possible effects should be kept in mind. For instance, a 25 per cent increase in United States exports to the sterling area—where discrimination is most stringent and effective—would amount to about $375 million, and a 10 per cent increase in exports to continental Western Europe and the nondollar countries of Latin America to about $250 million and $100 million, respectively, i.e. a total of about $700 million a year.

THE INTERNATIONAL IMPACT OF A UNITED STATES RECESSION

The international impact of a United States recession could hardly be estimated in advance with any degree of precision. It may be noted, however, that the mild recession experienced since the summer of 1953 has had a far smaller impact on foreign dollar incomes than was generally expected. Gold and dollar holdings continued to rise at a rate of more than $2 billion a year throughout the period October 1953–March 1954. Current and prospective levels of foreign aid and military expenditures—at a rate of $4.3 billion a year—will continue for some time to act as a powerful stabilizing influence on foreign countries' dollar earnings. For the next two or three years at least, a United States recession might be expected primarily to slow down the current accumulation of gold and dollars abroad, but it is highly unlikely to resurrect any large surpluses in the United States balance of payments with the rest of the world.

The international impact of United States recessions, however, is not limited to direct trade between each country and the United States itself. Their major disruptive effects lie in the transmission of contractive forces from country to country, through their own mu-

tual trade as well as through their trade with the United States.

The channels through which these indirect effects are propagated are of several kinds:

1. The demand of each country for exports from other countries—and not only from the United States—may contract automatically as a consequence of the lower income levels resulting from:
   a. The loss of export earnings to the United States.
   b. Possibly, the deterioration in its terms of trade associated with a United States recession.

2. This will affect income levels in the supplying countries and react in turn on their own imports from the first, spreading the contraction from each country to the others.

3. This spiral of contractive tendencies may be broken, or on the contrary accentuated, by the economic policies adopted in each country:
   a. Some countries may succeed, through compensatory policies, in preventing a decline in national income levels and maintaining their import demand at a higher level; their balance of payments will tend to deteriorate as a consequence, reducing previous balance of payments surpluses or causing a drain on their monetary reserves.
   b. Some countries may impose currency depreciation, tariff increases, or import and exchange restrictions as either (1) the consequence of reserve losses, whether automatic or resulting from the compensatory policies above, or (2) a substitute for such compensatory policies, in order to offset through increased exports and decreased imports the effects of the recession on economic activity, incomes, and employment. Such restrictions would aggravate the difficulties of other countries.

The international propagation and intensification of a United States recession can be considerably reduced by measures which will encourage and enable countries to follow compensatory policies (3a above) rather than disruptive policies (3b above) in the course of such a recession. The difficulties of the task will be far smaller if action is taken at an early stage rather than after the recession has been permitted to spread over a wider and wider area.

The direct impact of a United States recession will be heaviest on the countries most dependent on the United States market for their exports. Canada and Latin American countries sell in the United States market about half of their total exports, while Euro-

pean and sterling area countries trade far more extensively with one another and sell only about 10 per cent of their total exports to the United States (see Table 3). This ratio is substantially exceeded by only a few countries outside the Western Hemisphere—mainly the Philippines, India, Indonesia, and Japan. It varies greatly, however, among individual Latin American countries, from about 25 per cent in the River Plate countries to more than 80 per cent in Mexico, Guatemala, El Salvador, and Colombia.

TABLE 3

Gold and Dollar Holdings, Total Exports, and Exports to the the United States in 1953

(dollars in billions)

	GOLD AND DOLLARS HOLDINGS	TOTAL EXPORTS	EXPORTS TO U.S.	PER CENT RATIO OF EXPORTS TO U.S. TO TOTAL EXPORTS	PER CENT RATIO OF GOLD AND DOLLAR HOLDINGS TO:	
					Total Exports	*Exports to U.S.*
Continental Western Europe and dependencies	$10.06	$22.2	$ 2.51	11%	45%	401%
Sterling area	4.05	18.4	1.82	10	22	222
Canada	2.42	4.6	2.52	55	52	96
Latin America	3.63	7.6	3.58	47	48	101
Other countries	2.90	6.0	1.47	24	48	197
All foreign countries	23.04	59.0	11.90	20	39	194
International organizations	3.34	...	...	...	...	...
Total	$26.39	$59.0	$11.90	20%	45%	222%

Sources: Gold and dollar holdings: *Federal Reserve Bulletin,* March 1954, p. 245.
Total exports: *International Financial Statistics,* April 1954, pp. 22 and 24.
Exports to the United States: *Survey of Current Business,* Dept. of Commerce, March 1954, pp. 22–23.

A 30 per cent decline in exports to the United States would therefore have a very different significance for these various countries or areas. It would correspond to only 3 per cent of over-all exports and 7.5 per cent of gold and dollar holdings for continental Western Europe, but to about 16 per cent of total exports and 31 per cent of gold and dollar holdings for Canada.

There are also very great variations in the cyclical sensitivity of different countries' exports to the United States. Sterling area exports have usually been affected far more severely and those of Canada substantially less severely, than those of other areas during past United States recessions. Exporters of wool (Australia, New Zealand, Argentina, Uruguay), minerals (Bolivia, Chile, Mexico), and raw materials in general suffer a far heavier decline than

exporters of coffee, bananas (Brazil, Colombia, Central America), sugar, and other foods.

Taking into account both criteria—ratio of exports to the United States to total exports or GNP, and sensitivity of those exports to United States recessions—we should expect the most severe direct repercussions of a United States recession in some Western Hemisphere countries—particularly Canada, Mexico, Bolivia, Chile, Argentina, and Uruguay—and in Japan, the Philippines, Indonesia, and the overseas sterling area.

TABLE 4

Per Cent Changes in Exports to the United States

	1923–1924	*1926–1927*	*1929–1932*	*1937–1938*	*1948–1949*
Continental Western Europe	−6	. . .	−71	−32	−12
Sterling area	−11	−18	−79	−48	−18
Canada	−4	. . .	−65	−35	−2
Latin America	+1	−8	−68	−32	. . .
Other countries [a]	−8	. . .	−67	−34	−6
Total	−5	−6	−70	−35	−7

[a] Excluding Eastern Europe.

International policies designed to avoid or moderate the further spread and spiraling of the depression fall into two major categories: monetary policies and trade policies.

Untied loans in convertible currencies—whether from international institutions or from high reserve countries—may be necessary to relieve these countries of severe balance of payments pressures and enable them:

1. To avoid deflationary or restrictionist policies which will aggravate the depression elsewhere
2. To adopt positive compensatory domestic policies designed to sustain income levels, employment, and imports

The amount of assistance required for this purpose will depend, of course, on the level of these countries' reserves. Current ratios of gold and dollar holdings to total exports now average 40 to 50 per cent for all major regions except the sterling area (see column 5 of Table 3 above). Sterling area and EPU arrangements, however, result in a considerable economy of gold and dollar settlements in intra-area trade. As long as these arrangements continue, the need for external stabilization loans will be considerably less than it would otherwise be for Western Europe and the sterling area. The resources of the IMF in gold and United States dollars—more than $3 billion

—and in the currencies of other prospective creditors could provide all, or at least a considerable portion, of the residual assistance needed *and actually usable* to overcome the reserve deficiencies *arising from a United States recession.*

The latter qualifications, however, limit considerably the significance to be attached to international monetary cooperation as an antirecession device. Such cooperation may be more effective in preventing deflationary or restrictionist policies than in stimulating positive compensatory policies. The latter policies would prove very difficult to implement for many of the countries most severely affected by a United States recession, even if large stabilization loans relieved them of any anxiety about their reserve losses and balance of payments deficits. It is by no means easy to provide alternative employment for the men and resources left idle by the loss of export markets, especially in countries highly specialized in one or a few export products, such as tin, copper, and rubber.

Moreover, the ability of these countries to repay at a later stage the loans extended to them may very often be questioned by the prospective lenders. The lenders may take the view—rightly or wrongly—that balance of payments difficulties are aggravated during the recession, and will persist long after the end of the recession, as the result of ill-advised or irresponsible domestic policies. Disagreements on such points are likely to prove a stumbling block in many cases, especially when decisions have to be made—as is the case in the IMF—by many countries with diverse geographical, historical, and economic backgrounds. They may create far lesser difficulties in more closely knit organizations, such as the EPU and the sterling area, which group countries more highly interdependent economically, more keenly conscious of such interdependence, and more familiar with one another's problems and policies. While stabilization loans are a useful antirecession device, their limitations should be recognized and should prompt further efforts in other directions as well.

Commodity agreements and buffer stocks designed to reduce excessive instability in agricultural and raw material markets would be of far greater value to primary producing countries than monetary stabilization loans. The difficulties raised by such schemes are enormous, but so are their potentialities for economic stabilization and development.[17] One must regret, therefore, the rather cursory dismissal of this approach to the problem in the Randall Commission's report. Some of the Commission's recommendations, and

[17] See *Commodity Trade and Economic Development,* United Nations, 1953.

particularly the "avoidance of actions incidental to our own commodity control and stockpile programs that would have avoidably disruptive effects upon world prices"[18] and "continued consultation and cooperation with other nations to improve knowledge of world supply and demand for materials and food-stuffs, and to explore possible means of lessening instability,"[19] are all to the good, but give little hope for concrete action in the near future. This conclusion is clearly shared by the Commission itself, which also recommends "a policy of encouragement of diversification of the economies of the countries now excessively dependent upon a small number of products."[20] The benefits of international specialization must, to this extent, be sacrificed to the objective of domestic economic stability. In practice, however, the costs and difficulties of diversification policies may well be as formidable as those of commodity stabilization, or more so.

The above measures will at best reduce, but not eliminate, the direct impact of reduced earnings from exports to the United States on the monetary reserves and economic activity of the countries affected. They should be coupled with other policy commitments designed to avoid, to the maximum extent, the adoption of beggar-my-neighbor policies of currency devaluation, tariff increases, trade and exchange controls, discrimination, and bilateralism, which are a major factor in propagating and intensifying international recessions. The cooperation of the major and stronger nations is particularly vital in this respect. The influence of their policies on other countries, and their ability to use alternative measures to fight depressive tendencies at home, are usually far greater than those of the smaller or less developed economies.

No country, however, can be expected to renounce any means to improve its own domestic activity and employment, even at the expense of others, on the basis of Platonic appeals to international cooperation. While each may realize that the cumulative effect of mutual restrictions will be damaging to all, none will feel assured that its own restraint, or lack of restraint, in this respect will decisively influence the policies of other countries. Mutual commitments, of a positive as well as of a negative nature, encompassing credit provisions together with trade provisions, remain the most promising way to promote the maximum degree of trade freedom and cooperative antirecession policies. International agreements of the International Trade Organization or GATT type deserve greater

[18] *Report to the President and the Congress*, pp. 35–36.
[19] *Ibid.*, p. 36.
[20] *Ibid.*, p. 36.

United States support than they have received in recent years. On the other hand, in this field as well as in the monetary field, regional organizations may develop a far closer degree of intimate cooperation among the participating countries than can be anticipated on a world-wide scale. The combination of trade, credit, and economic policy commitments and negotiations into a single institution can also contribute to greater success in all three fields, as the OEEC experiment has amply demonstrated during its brief span of years. We thus rejoin the conclusions reached in the previous discussion of the best means to restore and preserve convertibility in a world of national sovereignties. Regional cooperation should be viewed as a valuable adjunct, rather than a rival, of world-wide agreements.

Conclusions

The current rate of gold and dollar accumulation in Western Europe and the sterling area, together with prospective rates of United States aid and military expenditures overseas over the next few years, provide a considerable cushion against a hypothetical United States depression. We should therefore expect a continuation, and even an acceleration, of the progress already achieved in recent years and months toward currency transferability and trade liberalization.

These, however, are fair weather objectives which can be pressed forward only in an environment of high economic activity and employment. In times of depression each nation will almost inevitably resort again to trade restrictions and currency inconvertibility in an effort to insulate its own economy from external deflationary pressures. These policies cannot be successful in the end, as each country's actions tend to aggravate the difficulties of others, widening and deepening the contractionist tendencies at work. National antidepression policies of this character have always proved in the past one of the main factors in the spread and aggravation of international recessions.

This spiral can be broken only by collective arrangements giving operational meaning to the interdependence of the various countries' policies. The avoidance of disruptive action should be made both possible and attractive through adequate access to stabilization assistance in case of need and through reciprocal guarantees against all unnecessary recourse to trade and exchange restrictions. Where restrictions become unavoidable, they should be limited

in scope and time, and unilateral discrimination against any country participating in the arrangements should be shunned.

International cooperation of this sort is, however, extremely difficult to negotiate and implement in practice. Moderation in its aims, hopes, and promises is indispensable to avoid later disillusionment, disaffection, and retrogression. Negotiation and implementation of world-wide arrangements are particularly slow and cumbersome, and such arrangements will necessarily remain more limited in their effective content than regional arrangements among countries which are highly interdependent, keenly aware of this interdependence, and readier to understand each other's problems and policies and to confide in the commitments and good faith of their partners.

Both types of approach should be developed and encouraged, and the potentialities of each should be as fully exploited as proves possible in practice. Much could be done today to improve the effectiveness of world-wide organizations such as GATT or the IMF. Much could be done also, under present favorable circumstances, to relax some of the regional limitations of the EPU and sterling area systems. Individual countries—particularly Britain, Germany, and the Netherlands—have recently taken important measures in this direction, but drastic revisions in the EPU Agreement to adjust it to the enormous changes which have taken place in the international pattern of trade and payments since the negotiation of the Agreement, four years ago, are now long overdue.

Major creditor nations—and especially the United States—will inevitably exercise a profound influence on the progress of other countries and of both regional and international organizations toward currency convertibility and trade liberalization. The United States has a major stake, economically and politically, in the promotion of liberal economic policies abroad and in the strengthening and development of other free nations. These objectives happily coincide with the interests of both consumers and producers in the reduction of tariff and trade barriers here, and with the need to provide increasing outlets for our exports of goods and capital.

The obvious shortcomings of the Randall Commission's report as a basic document on fundamental, long-term United States international economic policy have attracted more attention in academic circles than its very real contribution to the clarification of urgently needed, and immediately feasible, United States action in the monetary and trade field. The adoption of its major

recommendations would provide the necessary spark for further and considerable advances toward the rebuilding of a workable international framework for economic growth and stability.

COMMENT

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Triffin has performed a remarkable feat by presenting a discussion of the international trade and payments problem that is at once brief, comprehensive, and fresh. His principal conclusions, as I see them, are:

1. The international payments situation is now far better balanced than at any previous time in the postwar period, and far better balanced than is often realized, especially by those of us who have become so accustomed to a state of "dollar shortage" that we have come to regard it as a permanent feature of the economic landscape.
2. The steps required to achieve an effective multilateral system of trade and payments—"workable" convertibility, as Triffin calls it—are far less formidable than those required to reach what might be called "perfect" convertibility.
3. Such a multilateral system, if attained, would be a precarious fair weather system unless supported by international commitments and facilities designed to prevent it from collapsing at the first gusts of adversity.

With these major conclusions I am in hearty agreement. My comments will represent, on the whole, not disagreements but rather elaborations or qualifications of Triffin's argument, elaborations or qualifications which, in some cases, he might well have inserted himself if time and space had permitted.

Triffin has adopted the view that convertibility, to be meaningful, must apply in some sense to the sphere of trade as well as to that of payments. He has concluded, however, that we must reconcile ourselves to some element of protection of national markets, and he is unwilling to accept the principle that tariffs are permissible while quantitative restrictions are beyond the pale. Accordingly, he has defined as his goal the elimination of discrimination and bilateralism in trade and payments alike. This approach emphasizes the elimination of discrimination in the application of import restrictions, rather than reduction of the level of those restrictions.

Now a country which restricts its "hard currency" imports more drastically than its "soft currency" imports can eliminate that discrimination in either of two ways (or by some combination of the two): it can relax the more severe restrictions, or it can tighten up the less severe ones. Either course of action will result in nondiscrimination and therefore satisfy Triffin's criterion of "workable" convertibility.

This formulation of the problem may well be open to the interpretation, certainly not intended by Triffin, that either route to nondiscrimination in trade restriction is equally desirable, or to the less extreme interpretation that "workable" convertibility, achieved through the second route, the tightening up of the less severe import restrictions, is more desirable than inconvertibility. If freedom from restrictions is regarded as desirable, the first and more extreme interpretation can be dismissed at once, but the second merits some discussion. I doubt the desirability of convertibility if it must be attained at the cost of leveling up import restrictions.

The point is not academic, as further examination will indicate. Assume a country with an inconvertible currency, which maintains severe import restrictions against countries with convertible currencies, and more liberal ones against other inconvertible countries. (This assumption describes, with varying degrees of accuracy, the actual present position of most of the EPU members and many other countries.) The country now makes its currency convertible in the sense that nonresidents who earn it through legal current transactions are permitted freely to convert their earnings into any foreign currency.[1]

At this point, if the authorities took no further action, their currency would be convertible only in the strictly financial sense; they would not have attained "workable" convertibility because they continue to discriminate against imports from other convertible countries. This situation, however, is inherently unstable, because the distinction between "hard currency" and "soft currency" imports disappears as soon as the currency becomes convertible, and the authorities therefore lose any balance of payments reason to

[1] For example, if the currency in question were sterling, a French wine merchant (or, alternatively, his central bank) would be permitted to convert the sterling proceeds of his exports to Great Britain into dollars or any other currency he chose. In the following paragraphs the term "convertibility" will be used in this sense, which is of course narrower than Triffin's "workable" convertibility, since it applies only to currency arrangements, not to nondiscrimination in trade restriction. Convertibility in Triffin's sense will be referred to explicitly as "workable" convertibility.

discriminate unilaterally against imports from convertible countries.[2]

The authorities of the newly convertible country can take any of three courses of action with respect to their import restrictions (or any combination of the three):

1. They can eliminate discrimination by liberalizing the restrictions against countries with convertible currencies.

2. They can eliminate discrimination by tightening up the restrictions against countries with inconvertible currencies.

3. Despite the point just made, that the balance of payments incentive to discriminate disappears when the currency becomes convertible, they may nevertheless make no change in their import restrictions; that is, they may continue to discriminate. The rationale of this possibility will be discussed below.

It is possible to offer some general observations about the circumstances in which each of these courses of action is likely to predominate. If a country makes its currency convertible at a time when it, as well as other inconvertible countries, is suffering from a "shortage" (in some relevant sense) of convertible currencies, it is entirely likely that the establishment of convertibility will be followed by a tightening of import restrictions as between the newly convertible country and the remaining inconvertible ones. Some of the relevant criteria of "dollar shortage" are (1) unsatisfactory balance of payments and reserve position, (2) lack of access to substantial international credits or reserves, and (3) high suppressed demand for dollar imports which is dammed up behind the discriminatory import restrictions. If these symptoms of dollar shortage are present, a newly convertible country which liberalized its restrictions against hard currency imports could expect its payments position to deteriorate on two counts: its hard currency imports would increase, and its exports to inconvertible countries would decline as they began to treat it as a hard currency source

[2] For example, an import of French wine involves a cost in convertible currency as surely as an import of Canadian wheat or American cotton. This assertion implicitly assumes the further condition that current-account balances between Great Britain and France are not settled by short-term capital movements, official or private, but rather that they are ultimately settled, whether through the action of the market or the central banks, by the transfer of some other convertible currency, such as dollars, or in gold. If this condition is realized, the statement that British imports of French wine involve a cost in convertible currency or gold is valid whether Great Britain has a deficit in its bilateral transactions with France, which permits France on balance to convert sterling into dollars or gold, or whether Great Britain has a surplus which France must settle by converting gold or dollars into sterling.

in applying their own import restrictions. In an effort to avoid this deterioration, the newly convertible country might well narrow the margin of discrimination by tightening up its restrictions on imports from inconvertible countries.

The fear of some such sequence of events as this played an important role in the reaction of some of the continental EPU countries to the proposals for convertibility advanced by the British in the spring of 1953, and, as Triffin has pointed out, led to their insistence that convertibility must not mean abandonment of the OEEC trade liberalization program. Thus it is entirely possible to conceive of a situation in which the attainment of convertibility is accompanied by agreement among a group of countries to continue to discriminate in order to avert the danger of a wave of restriction. Although currency convertibility removes the incentive for unilateral discrimination on balance of payments grounds, it still leaves room for discrimination by multilateral or bilateral agreement. (There may, of course, be additional commercial reasons for discrimination.)

The question arises whether this narrow form of currency convertibility, unaccompanied by any change in trade restrictions, would serve any useful purpose. One of the major economic gains to be derived from convertibility is a more efficient utilization of economic resources in the world. If, however, the removal of currency restrictions is not accompanied or followed by any change in trade restrictions, the flow of trade and the utilization of resources will be unaffected. It is this consideration which has led Triffin, the Randall Commission, and others to emphasize that convertibility, to be meaningful and useful, must include nondiscrimination in trade restrictions as well as in payments.

How are we to evaluate the second possibility, in which the newly convertible country eliminates discrimination by tightening its restrictions on soft currency imports, while the remaining inconvertible countries reciprocate by restricting more severely their imports from it? The chances are excellent that the flow of trade will be reduced and the utilization of resources will become less efficient (although this latter result is not inevitable). Thus when convertibility and nondiscrimination are attained through the leveling up of import restrictions, they are probably of negative value. This consideration suggests that, in the appraisal of any move toward "workable" convertibility, interest should not be confined to the elimination of discrimination, but should extend to the level of the restrictions.

The foregoing discussion suggests that, if convertibility in the technical financial sense is established under adverse conditions, either trade restrictions will remain unchanged, in which case nothing will be accomplished, or they may become more severe (although less discriminatory), which will probably represent a retrograde step. The difficulty, when import restrictions are severe, of measuring the latent demand for hard currency imports that is repressed by those restrictions adds to the risk inherent in taking large discontinuous steps toward convertibility under unfavorable conditions.[3]

In any concerted effort to move away from a restrictive trade and payments regime such as characterized the postwar period, it is probably desirable that the establishment of currency convertibility be preceded by a gradual relaxation of discriminatory restrictions against hard currency imports. In this way the margin of discrimination would be narrowed before the more drastic step of establishing currency convertibility were ventured. In recent years the trend has been precisely in this direction.

My second comment relates to the situation in which, after convertibility has been attained, a severe decline in the imports of an important trading country puts pressure on the balances of payments and income levels of other countries. The scarce currency clause of the IMF agreement was designed to meet this situation, which is usually associated with depression in the United States. Triffin doubts the practical value of the scarce currency provision and suggests an alternative approach drawn from the experience of the EPU. Yet it is not entirely clear that his alternative will really meet the situation. Some of the alternative's major elements seem to apply to a quite different problem—the problem of a single deficit country which falls into balance of payments difficulties for reasons peculiar to itself—rather than to the problem of a large number of countries in deficit because of a depression originating in a single surplus country. It would certainly be highly unfortunate if, in response to a decline in the level of economic activity and imports of one country, the rest of the world immediately and automatically applied discriminatory import restrictions against the depressed

[3] It was widely reported that in March 1952, when the reserve crisis of 1951–1952 was still in progress, the British government came within a "hair's breadth" of making a "dash for convertibility," in the language of the London *Economist* (November 15, 1952). Such action would presumably have been confined to the currency field, and it might well have led to measures to make sterling scarcer by tightening trade restrictions.

country. It would be far preferable, if possible, to meet the situation by nonrestrictive measures. Nevertheless, if restrictions become unavoidable, there is a strong case for the general principle that restrictions limited to imports from the surplus country are preferable to all-round restrictions. Whether the scarce currency provision is a practicable and desirable method of applying this general principle is, of course, another question.

Before we leave the subject of discriminatory trade restrictions, it is worth noting that discrimination is a usual, if not inevitable, by-product of "economic integration" of groups of countries. If two or more countries reduce the economic barriers among themselves, in connection with an agreement to coordinate their economic policies (e.g. the Benelux Union, not fully implemented) or to establish a unified market in a specified group of products (e.g. the Schuman Plan), they will probably be unwilling to extend this liberalization to the rest of the world. Such integration may well be desirable even though it implies discrimination.

In his final section Triffin refers to the tendency for dollar shortage to appear when the United States develops less inflationary pressure, or greater deflationary pressure, than the rest of the world. He appears to regard this tendency as sufficient explanation for the dollar difficulties of the postwar period. While accepting it as an extremely important element in the explanation, I should be inclined to give some weight to at least two additional factors, which might be described as nonmonetary.[4] The first is the impact of the war on European capacity to produce and to earn foreign exchange. The second is the effect of longer-term changes in the economic relations between the older industrial areas of Western Europe and the newer industrial and primary producing areas of the rest of the world. It is at least a possibility worth considering, one which can only be mentioned here without elaboration, that economic development in the rest of the world has caused changes in the conditions of international demand and supply which have been unfavorable to Western Europe, at least in part and in their initial impact, and that

[4] The distinction between "monetary" and "nonmonetary" factors is, of course, notoriously treacherous. It could be argued, for example, that the "nonmonetary" factors referred to here, although they would affect real incomes, would not give rise to balance of payments deficits or dollar stringency if inappropriate "monetary" policies did not prevent adjustment of the balance of payments. Whether or not this contention is valid, our present concern is with the factors causing the initial disequilibrium, not with the failure of the system to establish a new equilibrium instantaneously. It is not believed that the use of the term "nonmonetary" will give rise to misunderstanding in the context of the present discussion.

this unfavorable development has, for a variety of reasons, manifested itself in the form of "dollar shortage" in the postwar period. If this hypothesis has any validity, it would suggest that one of the factors that determines the stability of the present state of international balance is the extent to which the structure of world trade has been readjusted in response to these long-term developments. A familiar example of the kind of readjustment that has been required in the past in response to developments in the rest of the world is the long-sustained decline in the share of British exports represented by textiles, which began well back in the last century, and the increase in the share represented by engineering products.

Triffin calls attention to the striking improvement in both the magnitude and the distribution of the gold and dollar reserves held outside the United States. While his observation is valid in general, it should be noted that the distribution of reserves at the end of 1953 was still not as favorable to the sterling area as might be considered desirable in relation to possible needs and commitments. Nor, according to Table 1 in Triffin's paper, was it as favorable as in 1938, when the sterling area held 28 per cent of the gold reserves and dollar holdings outside the United States, as compared with 15 per cent at the end of 1953.[5] The adequacy of sterling reserves is, of course, of particular importance since current discussion of convertibility revolves around convertibility of sterling.

The Randall Commission and others have argued that the present state of world dollar balance conceals a substantial dollar gap associated with the "extraordinary" dollar expenditures of the United States government in foreign countries for defense purposes, including stockpiling, offshore procurement, construction, and the support of United States military establishments. Triffin rightly points out that, unlike aid, these disbursements are not unilateral transfers which are costless to the receiving country, since they represent payment for currently produced goods and services. As the disbursements decline (if they do), the resources producing the goods and services will be released and will become available for other purposes, including support of the balance of payments of the foreign country concerned. Although it is true that the resources will be released, it does not by any means follow that they can readily and smoothly be reabsorbed (as Triffin concedes). The

[5] It should be added that official gold and dollar reserves of the United Kingdom increased by a further half billion dollars between the end of 1953 and the middle of 1954, and that the share of world reserves held by the United Kingdom in the late thirties was considerably higher than in preceding periods.

problem of adjustment will be aggravated because a high proportion of the extraordinary disbursements represent payment for such services as housing and local labor supplied to United States establishments. In the case of services, it is particularly difficult to see how the resources released can be redirected in such a way as to fill the gap in the balance of payments arising from the loss of these receipts.