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Volume Title: British and American Plans for International Currency Stabilization

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Volume Publisher: NBER

Volume ISBN: 0-87014-331-X

Volume URL: <http://www.nber.org/books/ridd43-1>

Publication Date: 1943

Chapter Title: Feasibility of the Overall Approach

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Chapter URL: <http://www.nber.org/chapters/c4633>

Chapter pages in book: (p. 22 - 31)

## FEASIBILITY OF THE OVER-ALL APPROACH

The advantages of stable exchange rates are widely recognized. The consequences of disorganized and unstable exchanges were amply demonstrated in the period between the two wars. The merits of an international organization to help promote and maintain exchange stability are also admitted. It could develop trained and able men who would devote their efforts to the problem of stabilizing the exchanges and to the promotion of international economic cooperation.

### TRANSITION PERIOD

In working out any scheme for stabilization, however, due consideration must be given to the conditions that will prevail in the immediate postwar period, i.e., the period of transition from war to more stable economic conditions. Our first concern is with that transition period.

It is not the purpose here to examine critically the differences between the two plans or to compare the merits of the one with those of the other. The general concepts and techniques of the two plans are similar. The important question is whether any plan of this nature would be workable under the conditions that will prevail in the postwar period. These plans seem to be based on the following assumptions: (1) that international payments of the member countries will be in essential equilibrium, or can be brought into equilibrium rather quickly with only minor adjustments,<sup>8</sup> and (2) that the adjustments contemplated would be acceptable to the countries involved as well as to the governing board of the agency. In other words, these plans seem designed to operate in a stable and orderly world where debit balances are of a temporary nature and where general economic and political stability prevail.

No such order and stability will prevail in the transition period. The problem will be to restore stability in a badly disordered world. Some countries will have heavy debit balances and others heavy credit balances. Any such mechanism as that proposed by White or Keynes would be badly battered by the tidal waves that follow in the wake of war.<sup>9</sup> The rates existing now, and the rates which Mr. White would use in initiating over-all stabilization, are pegged rates and in many cases will turn out to have little re-

<sup>8</sup> Cf. *London Economist*, August 28, 1943, p. 261.

<sup>9</sup> Jacob Viner expressed the same viewpoint as follows: "To put on what is intended to be a long-run monetary stabilization agency any important responsibilities with respect to the handling of the emergency problems of the transition period—problems difficult not only technically but because of their magnitude, their political entanglements, their acutely controversial character, and the absence in many cases of solid, established governmental authorities to deal with—would be to put a curse on the agency from the start." ("Two Plans for International Monetary Stabilization," *The Yale Review*, Autumn 1943, p. 105.)

lation to the fundamentals of the various economies in the postwar period. The same may be said of any rates that might be established in the immediate postwar period. The real external purchasing power of most currencies is at present affected by internal exchange restrictions and regulations and, in many cases, is likely to be substantially lower than the pegged rates now prevailing.

It has rarely been possible for countries deeply involved in wars to return quickly to stable exchange rates. Even England, who has always been jealous of the pound's reputation and exceedingly careful to maintain its stability, did not attempt to establish definitive rates after the first World War until 1925, seven years after the Armistice. The readjustment of internal economies and the reestablishment of normal trade relationships often require years of continuous effort. An attempt to stabilize rates under the provisions of either plan could prove entirely futile and result in the dissipation of credits without any lasting accomplishments. Exchange rates cannot be fixed by agreement and maintained by fiat unless they reflect basic economic conditions. The sponsors of the American plan would probably concede that many countries may not be ready immediately after the war to become participating members in the plan, and that it might be years before some countries would be ready to share fully in the duties and responsibilities of such membership. Conceding the limitations of the Fund and the difficulties of including all nations initially, however, would strengthen the case for the key-nation approach, which will be discussed later.

Both plans provide some elasticity in exchange rates, but obviously not enough to permit major changes without the approval of the directors. A change of five or ten percent would not be sufficient to meet the shifting conditions and rapid readjustments that will probably characterize the transition period. Changes beyond those narrow limits require approval of the board of directors, but it might be difficult to get such approval either by majority vote or by a larger vote.<sup>10</sup>

One objective of both plans seems to be to void the so-called rigidity of rates under the gold standard. It may be pointed out, however, that under the gold standard, nations could and did change rates at times to meet basic conditions. It is claimed for these plans that they provide a mechanism for adjusting rates by agreement, when necessary, so as to prevent unilateral competitive action. It is debatable, however, whether either of them could provide sufficient elasticity to meet the requirements of the transition period and still make any progress toward stability. Furthermore, the question arises whether some plan for general consultation over proposed rate changes

<sup>10</sup> *Ibid.*, p. 93.

could be worked out without setting up such a mechanism for credits and controls.

Instability of the exchanges is a symptom or reflection of disorders elsewhere, and the problem is to cure those disorders. No country can maintain a stable currency unless its internal economy is in order—its budget under control, its price level reasonably stable, and its external payments and receipts roughly balanced. During the critical transition period efforts will be made to reestablish orderly political and economic conditions within the countries most seriously ravaged by war. This is a task primarily of internal rehabilitation, which will have to be supplemented by external aid in some form of lend-lease extension and long-term loans for reconstruction purposes.

Even if such a plan did not break down in the transition period, it might be in such a frozen condition at the end of that period that its effectiveness would be seriously impaired. If some countries should pile up huge debit balances while a few others, notably the United States, accumulate huge credit balances, the Fund (or Union), when faced with the problem of maintaining exchange stability in a more orderly world after the transition period, would be greatly handicapped by these huge debit and credit balances already created. A debtor country would be in the position of having exhausted its credit line and having to adopt restrictive measures because of conditions having nothing to do with its current balance of payments. Likewise, a creditor country would be in the position of being urged by the Fund to adopt expansionist measures because of conditions having nothing to do with its then current balance of payments. In other words, the abnormal conditions of the transition period could so affect the Fund as to interfere materially with its usefulness later on.

Even in more normal periods it seems doubtful whether adjustments could be made within the borrowing limits contemplated in the White plan or whether such a mechanism could withstand the stresses and strains that may occur occasionally. Major economic disorders in the world might create such huge imbalances as to make it almost impossible for a mechanism of that character to operate. Furthermore, the system of multilateral trading was badly disorganized in the 1930's, and will probably not be quickly restored to effective operation. Until the multilateral system is restored, and a reasonable degree of balance in international payments is achieved, it is difficult to see how such a plan could operate successfully.<sup>11</sup>

<sup>11</sup> Friedrich A. Lutz of Princeton University, in a careful analysis of the two plans from the viewpoint of permanent exchange problems, concludes that while they have advantages for the transition period they do not give a solution which can be regarded as satisfactory for the long run. He says: "They avoid clear-cut solutions such as the gold standard, or a paper standard, or one single Central Bank for all countries would offer. Free exchange markets but also foreign exchange control, fixed exchange rates but also currency depreciation (and in addition perhaps

Long-term loans that might be resorted to in the transition period would not necessarily bring about a quick equilibrium in a country's economy or a permanent balance between external receipts and payments. Such loans, if wisely made for reconstruction and development purposes, could expedite essential fundamental adjustments, but they might not correct a lack of balance in current payments. The experience of the 1920's shows that substantial credits may be granted without producing the equilibrium necessary for establishing and maintaining definitive exchange rates. Long-term credits, therefore, would not be a guarantee that the demands on a stabilization fund of the kind proposed would be reduced sufficiently to make the Fund workable in the transition period.

### OBSTACLES TO IMMEDIATE EXCHANGE STABILITY

The obstacles to immediate stabilization of exchange rates for all countries may be grouped under three heads: political instability, internal economic instability, international trade dislocations.

#### *Political Instability*

We do not know what the map of Europe will look like when this war is over, or when any semblance of political stability will be restored. We do not know what countries will continue to exist in Europe, what their boundaries will be, or in whose sphere of influence they will operate. Internal strife may break out in some countries. It will take time to create conditions favorable for exchange stability. The bickerings now going on between factions of some of the United Nations do not inspire hope of any quick settlement of political problems. Some of the powerful nations may not care to cooperate in such international organizations as these, or may even frown upon the participation of the smaller nations living within their sphere of influence. Until genuine peace and confidence have been restored, it may be impossible to attain sufficient economic stability to stabilize exchange rates generally.

#### *Internal Economic Instability*

A second difficulty in the over-all approach is the economic and financial chaos that will probably prevail in many countries at the end of the war.

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a small dose of deflation), the use of gold as international currency but without its having any role as an integral part of the mechanism of international adjustments; all these ideas are merged into one plan. It is unlikely that such a combination will work satisfactorily. It seems more probable that one of the mutually inconsistent ideas worked into the plans will win out. As it stands, the least desirable, foreign exchange control, would seem to have the best chance." ("International Monetary Mechanisms. The Keynes and White Proposals," *Essays in International Finance*, No. 1, Princeton University Press, July 1943, p. 21.)

Loss of productive facilities and drastically unbalanced budgets leading to monetary troubles within many countries may make it impossible to fix rates of exchange with any degree of permanency. It would be very hazardous and costly, for example, to maintain a fixed rate for the French franc while inflationary influences in that country are unchecked and before some degree of economic order is restored. A number of foreign central banks and private commercial banks will have to be reorganized, their unrealizable assets written down, and their inflated bank note issues reduced. Some countries may be able to bring about a quick restoration of internal stability; others may find it a prolonged and discouraging process.

As a rule, a currency is unstable because of difficult domestic problems, such as heavy unemployment and a seriously unbalanced budget, which may be tied up with internal political considerations. For an international body these internal economic problems would be hard to cure. Loans and credits might afford temporary relief, but necessary reforms might be postponed. Much groundwork will need to be done within individual countries by way of restoring their economies to stable conditions before their proper places in an international organization can be determined. Internal stability is a prerequisite to enduring external stability.

### *Trade Restrictions and Dislocations*

A third obstacle will be the disorganized and chaotic state of world trade, and the numerous trade restrictions that exist. It will take time for new trade relationships to develop and for their effects on the balance of payments to be felt. What, for example, will happen to the Dutch East Indies and their markets for rubber, tin, and other products? No doubt the reconstruction of trade and exchange must be carried on simultaneously, but to attempt to set up an all-embracing exchange stabilization scheme before some of these trade problems are reasonably well worked out might lead to so many maladjustments that the stabilization scheme itself would break down. Unless there is some stability and equilibrium in trade, it is almost impossible to stabilize exchanges on any sound basis. Equally important is the question as to what changes will be made in tariffs, quotas, and other restrictions which hamper the free flow of international trade, and what the effect of these changes will be.

The lack of balance in trade is often a principal cause of the lack of balance in international payments, and that obstacle cannot be overcome by monetary policy alone. A system of multilateral exchanges of goods and services that will reflect each country's true economic requirements is essential to a system of multilateral clearings. The international integration necessary to promote a reasonable degree of equilibrium in the payments between coun-

tries will require far-reaching economic cooperation, particularly in the field of commercial policy. After the dislocations and diverse developments of the past ten or fifteen years, this integration cannot be accomplished in a short period of time.<sup>12</sup>

### RELIANCE ON CREDITS

The two plans rely heavily upon credits to solve the world's exchange problems. It would be possible for many countries to follow the easy course and borrow as long as credits are available. If the provisions in the plans for exercising pressure on debtor countries prove to be ineffective, these credits, instead of accelerating necessary fiscal and economic reforms, might postpone them. In fact, the plans are designed to facilitate gradual rather than abrupt adjustments. The difficulties of many debtor countries might be obscured for a period by stabilization credits, but they might build up economies that could continue only on the basis of a constant inflow of credits. When the supply of these credits is exhausted and no long-term loans are available, the inevitable adjustments might prove to be more painful than if they had been made in the first place.

After World War I large credits were used to stabilize the continental exchanges but they broke down because the necessary readjustments were not made. Some students of that period believe that smaller loans made with more discrimination and conditioned upon adequate financial and monetary reforms would have accomplished much more.<sup>13</sup>

Bringing all countries immediately into a stabilization agency at the end of the war might impose upon its credit mechanism insoluble problems from the outset. Some countries might have to be carried for years without attaining internal political and economic stability. In theory this agency would be set up to grant short-term credits but in practice many of them might well turn out to be long-term or permanent credits. As pointed out earlier, the practical difficulties of separating exchange stabilization credits from relief and reconstruction loans in the postwar period would be very great. The freezing of the available credits into long-term loans might cause the system to bog down unless the creditor countries were willing to continue extending credits.

The hope is expressed by the sponsors of both plans that other instrumentalities would be set up to handle relief and long-term loans for rehabilitation and reconstruction, in which case the problem of frozen stabilization credits might be less serious. As previously pointed out, however, long-term

<sup>12</sup> See the discussion of these problems by Folke Hilgerdt, "The Case for Multilateral Trade," *American Economic Review*, Supplement, March 1943, pp. 406-07.

<sup>13</sup> Benjamin M. Anderson, "Postwar Stabilization of Foreign Exchange," *The Economic Bulletin*, Vol. IV, No. 1, May 11, 1943, pp. 18-19.

credits would be granted for specific purposes and might not remedy a lack of balance in current payments. At any rate, an adverse balance cannot be offset indefinitely by long-term credits and a stabilization mechanism of the kind proposed might not be prevented from breaking down under the impact of continued lack of balance in international payments.

A system of quotas or shares in a credit pool might encourage debtor countries to believe that they have a "right" to credits sufficient to balance their international payments and receipts and that such credits need not be liquidated. It would raise hopes that could not be fulfilled, and invite abuses of the credit facilities to the extent that the safeguards provided in the plans prove inadequate.

Stabilization loans might be more effective in promoting permanent exchange stability if granted on the same principles as other credits; that is, if each individual case is considered on its merits and the granting of the loan is conditioned upon the carrying out of necessary fiscal and monetary reforms. Too liberal credits might not be any more effective in the international field than in the field of business. Each country has the primary responsibility for working out its own problems; in order to receive credits, there should be evidence that it has both the intention and the ability to bring about the necessary fiscal and monetary reforms and to make other essential economic adjustments.

A subtle problem of organization arises at this point. Presumably many, perhaps all, member nations would be borrowers at times and lenders at times. American banking history suggests the danger of having applications for loans passed upon by the would-be borrower, or groups of would-be borrowers who have sometimes been able to vote one another unwarranted loans. There may be equal danger in going to the opposite extreme and leaving decisions concerning loans wholly to creditor interests. How then shall applications for loans be passed upon in the international organization—by a full directorate composed of the representatives of both borrowing and lending nations, or by representatives of the lending nations only, or by the representatives of all but the applicant nation?

It is practically impossible to determine in advance how much credit any particular country may need or under what conditions it should be granted. The setting up of a uniform system of quotas and credit facilities based upon the volume of trade, national income, gold holdings, etc., may have no relationship whatever to the relative credit needs or the creditworthiness of the various countries. If the credit pool and the quotas are made large enough to assure every country what it may need, it offers an opportunity for others to take advantage of the credits available, whether they are needed or not. Certain safeguards are provided, of course, and additional safeguards could

be imposed. But in view of the intricacies of international transactions, it is not certain whether any safeguards would be effective against a country inclined to hide its foreign assets in order to make use of the agency's credits to the full extent.

### INFLATIONARY INFLUENCES

In the immediate postwar period when the world will be combating the inflationary influences generated by the war, the Keynes plan might add more fuel to the fire. The creation of such a huge fund of available credits would no doubt greatly stimulate the dollar amount of foreign trade as long as credits are provided, but, if and when they are refused, readjustments could prove to be very painful. The consequences would be similar to those of other booms built on inflated credit.

The effect on the United States might be particularly aggravating at a time when demands will be heavy and goods scarce. The stimulation of foreign buying in the immediate postwar period would greatly increase the difficulties of supplying the deferred demands of the public and of holding prices in check. If the trade boom should collapse about the time the rebuilding of inventories tapers off and the demands for durable goods slacken, it would accentuate the consequent business recession.<sup>14</sup> The postwar inflationary impact of the White plan would be much less than that of the Keynes plan because of the smaller volume of credits that would be extended.

It is to the interest of the United States, of course, to develop foreign markets for its products, and this development can be aided by the granting of credits. The benefits of a "mushroom" growth stimulated to excessive proportions by short-term credits in the immediate postwar period, however, might not be lasting. In all likelihood, export trade developed more slowly and without undue pressure, aided by long-term credits for reconstruction and development purposes, will have more permanence and stability.

### POTENTIAL CREDIT BURDEN ON THE UNITED STATES

Unless we decide to retire from international economic affairs, the United States will have to play the role of the principal world banker after this

<sup>14</sup> John H. Williams points out that, "the world may be confronted during the transition from war to peace with an excess of purchasing power and a deficiency of peacetime goods, so that for a period, at any rate, a policy of monetary expansion might carry more promise of inflation than of increased real income and employment." *Op. cit.*, p. 653.

Imre de Vegh says: "A potential further export demand of the proportions made possible by the Keynes Plan during the reconstruction period means to invite inflation and subsequent disaster." *Op. cit.*, p. 541.

Friedrich A. Lutz points out that the Keynes plan has a permanent inflationary bias because quotas rise automatically with the aggregate value of international trade. *Op. cit.*, pp. 7-10.

war, both in granting short-term credits and in making long-term loans. Having made the initial decision, we cannot escape playing this role. The problem is whether either of the mechanisms proposed would be a suitable or effective method of extending these credits and carrying out our world responsibility. It is impossible to tell from either of these plans alone how deeply we might become involved in the matter of extending credits and loans. To prevent the stabilization agency from becoming frozen or bogging down, we might find it necessary, apart from the initial contribution, to extend more and more credits as time goes on or, if we want to avoid this, to increase greatly our purchases of goods and services from abroad. The machinery of each plan is set up in such a manner that the creditor countries, which means chiefly the United States, could extend credits up to very large amounts and might be called upon to do so in order to prevent operations from collapsing, unless we decide to keep our external receipts and payments roughly balanced in other ways.

### ECONOMIC CONTROLS

The operation of either plan would involve certain economic controls affecting both international transactions and domestic affairs. Under both plans a member country renounces the right to alter the gold content of its currency without the consent of the governing board, with the exceptions noted above. Under both plans, but more specifically under the Keynes plan, the money markets of the individual countries will be affected. Furthermore, Keynes suggests that the Clearing Union might become the pivot of the future economic government of the world and might be used to maintain stability of prices and to control the trade cycle, if that is desired.

Both plans assume that short-term capital movements would have to be regulated in the interest of stable exchanges as long as political and economic disorders make this necessary. Yet one of the consequences of regulating short-term capital movements may be increased supervision over all international transactions. To operate successfully and fairly the agency might be compelled to require the registration of all gold and foreign exchange holdings and of all international transactions of member countries and their nationals. Even then, its efforts would probably be defeated in a measure by various devices. The only way to prevent capital exports of a speculative or political nature is to remove the causes, and this goes back to the problems of political and economic stability.<sup>15</sup>

Under conditions which prevailed in the world prior to 1914, the free flow

<sup>15</sup> For the contents of this paragraph I am indebted to Friedrich A. Lutz, who has given an excellent discussion of the difficulties and implications of trying to control capital movements. *Op. cit.*, pp. 17-19.

of funds, especially short-term funds, from one country to another in response to favorable interest rates and investment conditions supplied the balancing factor in international payments, and there was no necessity for any over-all control of credits and capital movements. If genuine peace and stability are restored to the world after this war and responsible governments are set up in the various countries, the consequent return of international confidence will doubtless again lead to the free flow of funds from countries of relative abundance to countries of relative scarcity. Under those conditions an elaborate international organization with broad controls and powers would be superfluous. In fact there is some question as to whether the setting up of such an organization as that proposed might not actually retard or impede the free movement of funds according to economic needs. If the investor is faced with the fact that controls over capital exports may be imposed at any time according to fixed international policy, he may be somewhat reluctant to put his funds in a foreign country.

The controls involved in such plans might come into conflict with internal policies. In recent decades, for example, the United States and other countries have become acutely conscious of the employment problem. Employment, in fact, has become one of our major political problems, and much of the economic thinking and planning of governments revolves around that issue. It is doubtful whether member countries will accept outside jurisdiction over that problem or will make international commitments which might interfere with the handling of the employment problem at home. It cannot be assumed that nations will administer internal affairs with the primary objective of balancing external payments.

The most important practical consideration for any proposal is its adoption by the various governments of the world. Because of the controls necessary for the operation of these plans, a number of countries may hesitate to accept them, especially in view of doubts about their effectiveness and about the necessity for setting up agencies with such broad powers and large funds. Although the experience of the interwar years seems to indicate that some international cooperation will be necessary to attain stable conditions in post-war international affairs, it is not clear how far the United States will be ready to go. The American people have been predominately domestic in their trade and business activities. International controls of the type suggested by the Keynes and White plans may appear to many among us needlessly complicated. A less formalized arrangement might gain initial all-round approval more easily and perhaps grow as experience is acquired in handling international matters.