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# INTERNATIONAL MONETARY MECHANISMS

## *THE KEYNES AND WHITE PROPOSALS*

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*In April of this year the British government published proposals by British experts for an "International Clearing Union." At the same time the United States Treasury circulated a "Preliminary Draft of a Proposal for a United and Associated Nations Stabilization Fund." The British plan is generally considered to be, predominantly, the work of Lord Keynes, and the American plan the work of Dr. Harry D. White. This paper discusses these proposals which will be referred to, respectively, as the Keynes and the White plans. The section numbers of the White plan (e.g., V, 1), to which reference is made in this essay, are taken from the text of the plan as published in* The New York Times *of April 7, 1943. The Keynes plan was published in this country by British Information Services, New York, as of April 8, 1943, under the title* International Clearing Union.

# THE KEYNES AND WHITE PROPOSALS

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## I. INTRODUCTION

THE international monetary problems which will confront the world after the war are of two types, temporary problems, which will arise only in the period of transition to "normal" conditions, and problems of a more permanent character.

During the period of reconstruction some countries will tend to have a strongly passive balance of payments. As an example we may take Great Britain. There is no doubt that the long withheld demand for raw materials and agricultural products will lead to an increase in British imports. The Dominions, moreover, hold considerable short term balances in London, frozen for the time being, but likely to be withdrawn as soon as foreign exchange control is dropped. In the absence of any international cooperation, Great Britain would have the choice of retaining foreign exchange control, along with bilateral agreements, for a considerable period after the war, or of letting sterling find its own level. Neither of the alternatives is very attractive. There is an understandable desire to get rid of all the impediments to international trade and, of these, foreign exchange control is one of the most severe. To let the foreign exchange rate fluctuate freely immediately after the war is, on the other hand, far from advisable. Quite apart from the disturbing influence which speculation in the currency may have on its general level, it is safe to say that, under the impact of the sudden demand for foreign exchange from the two sources mentioned above, sterling would depreciate much more than would, in the long run, be required. Other countries would then complain about "unfair" competition, based on an undervalued pound sterling, with the result that we might again find ourselves in a period of competitive exchange depreciation and currency wars.

Of the problems of a more permanent nature three deserve particular mention.

1) Under the gold standard the total volume of international currency was dependent on the accidents of gold production. As the quantities of national currencies were based on the monetary gold stocks of the countries concerned, the world was thrust into periods of alternate deflation and inflation. A better method of regulating the volume of international currency must be sought.

2) In the 19th century, Great Britain and France, at that time the main creditor centers, lowered interest rates whenever they obtained gold from a favorable balance in their international accounts, and thus immediately stimulated foreign lending by their nationals. This released the countries which were losing gold from the necessity of submitting to a process of severe deflation. In the twenties, of this century, the mechanism failed to work, because the United States, then the main creditor country, prevented the incoming gold from affecting interest rates at home at any time that lower interest rates failed to fit into the domestic monetary policy. The result was that the countries losing gold had to bear the whole burden of rectifying the disequilibrium in the balance of payments. Since the process of deflation which this involved is painful, most countries, faced with a considerable loss of gold, simply preferred to go off the gold standard. The question arises whether a procedure cannot be developed which will both make the adjustment easier and oblige the creditor country to share in it.

3) The third problem is closely connected with that just discussed. The period between the two wars showed the disruptive influence which capital movements can have on equilibrium in the balance of payments. The necessity for devaluing a currency was often the result of a capital flight associated with political and speculative influences. Is there a way of avoiding such capital movements?

The Keynes plan proposes the setting up of machinery intended to solve both the transitory and the permanent problems in international monetary affairs. This is also true of the White plan but the latter is not purposely concerned with the regulation of the volume of international currency. Principal attention, in this essay, will be devoted to the permanent problems. Before considering the contribution of the two plans to the solution of these problems, however, we should say something about the general character of the machinery that they envisage.

## II. THE "INTERNATIONAL CLEARING UNION" AND THE "UNITED AND ASSOCIATED NATIONS STABILISATION FUND"

ACCORDING to the Keynes plan an "International Clearing Union" is to be set up. The Union starts out without any funds whatsoever. Each country has a quota in the Union which consists simply of a line of credit with the Union in terms of a unit called "Bancor." If a country (either through its Treasury or through its Central Bank) draws on the Union, the following entries will appear in the Union's books: on the assets side there will be a loan (in terms of Bancor) to the country drawing the check and, on the liabilities side, a deposit in favor of the country receiving and depositing the check. The Union thus creates its own funds and, for this reason, can never run out of them. The transaction just described amounts, of course, to a credit given by the country with the credit balance to the country with the debit balance. Credit balances may also be built up through the deposit of gold with the Union. The quotas of the various countries determine not only the credit facilities which the countries enjoy but also their voting power, subject to the proviso that no country shall have an absolute veto. The quotas are based on the relative importance of the member countries in international trade. If the figures suggested in the plan were adopted, the initial quota for each country would be 75 percent of its total average exports and imports during the last three years before the war, and would then change automatically on the basis of a three-year running average of total imports and exports and, later, a five-year average. The initial quota of Great Britain would be approximately $5.5 billion, the American quota (if we omit the gold imports in the three last pre-war years) would be approximately $4 billion.

The formal set-up under the White plan is quite different. Unlike the Union, the Fund does not start out without contributions. On the contrary, each country must subscribe a certain amount, called its quota, fifty per cent of which must be paid in in the form of gold, local currency, and government securities, in specified proportions. The rest of the quota may be called later. The Fund's balance sheet would then show, on the assets side, gold, currency, and government securities of all the member states. It is not clear what corresponds to these assets on the liabilities side. Presumably the idea is to have a capital item, with each country having a share in this capital corresponding to the paid-up part of the quota.[1] In addition, there might be, on the liabilities side, "Unitas" deposits which a country may obtain against the deposit of gold. The

[1] The other possibility of giving each country "Unitas" deposits seems excluded by the fact that these deposits have to be covered 100% by gold. It may be noted that the plan sometimes refers to a country's "exhausting its quota" (III, D). This is an unfortunate expression. The original contribution of a country can be exhausted, but this could only be due to an active balance of payments of this country with the rest of the world. We should have to say in this case that the other member states exhaust this country's quota by buying its currency from the Fund. What is meant is obviously that the country concerned has a *passive* balance of payments, with the result that the Fund must sell to it the currencies of other countries. "Exhausting the quota" in this context means that a country has bought foreign exchange from the Fund up to an amount equal to its quota, with the result that the Fund holds three times the amount of local currency, local securities, and gold originally paid in by the country concerned. (This assumes that only 50% of the quota is paid in when the Fund starts to operate.)

books are to be kept in "Unitas," a unit of account which is equal to ten American dollars.

The operations of the Fund would consist in changing the assets around, selling, say, sterling against dollars at one time, Swiss francs against Canadian dollars at another time, and so on. The activities look different from those of the Union, but the difference is formal only. If the amount of currency of one country among the assets of the Fund decreases in favor of a corresponding addition to the amount of the currencies of other countries, this means that the former gives credit to the latter, just as a country building up a credit balance under the Keynes scheme gives credit to those building up debit balances. The Keynes plan has the advantage of a simpler structure and shows, clearly, the nature of the economic phenomenon behind the transactions of the international institution. It also avoids the quite unnecessary trouble, imposed upon the member states by the White plan, of going through the procedure of paying in contributions.

The White plan suggests that a country's holdings of gold and foreign exchange, the magnitude of the fluctuations in the balance of payments, and the national income, should all enter into the determination of the quotas. This formula, no matter what the details might be, would give the largest quota to the United States, just as the British formula would give it to Great Britain. But whereas the British plan excludes a veto power by any one member state, the American plan would, without doubt, give such power to the United States. This follows from the fact that, on the one hand, a country may be entitled to cast as much as one-fourth of the aggregate votes (V, 1), and that, on the other, all important decisions must be taken with the approval of a four-fifths vote of the Board. It is true that the plan does not state that only one country shall have one-fourth of the aggregate votes but, if Great Britain as well as the United States should obtain one-fourth, then, in the case of disagreement between those two countries alone, no major decision could be taken. If, on the other hand, only the United States were equipped with veto power, this country would actually run the Fund.

## III. THE PROBLEM OF THE VOLUME OF INTERNATIONAL CURRENCY

As the White plan is not specifically concerned with the problem of the volume of international currency, our discussion in this section will be concentrated on the ideas of Keynes though some remarks will be made, at the end of the section, on the implications of the White plan. The minor role which gold plays in the Keynes scheme will, for the moment, be disregarded.

A member state, under the Keynes plan, could and would look at its quota as its reserve of international currency, corresponding to its gold reserve under the gold standard. Running into debt with the Union, which is identical with using up part of its quota, would correspond to the loss of gold, i.e., it would lower the international liquidity of the country concerned. The repayment of previously incurred debts to the Union, or the building up of a credit balance, would correspond to the gaining of gold. The volume of internal currency could be expanded in the latter case and must be contracted (or else the currency would have to be devalued) in the former case. It seems strange, at first, that a Central Bank could look upon a line of credit as its reserve of international currency but, since the Union which grants the line of credit is an international institution equipped with the power to create the international currency, "Bancor," there is nothing surprising in this fact which parallels a Central Bank credit for commercial banks within any national jurisdiction.

The sum total of international currency would be equal to the sum total of the quotas, just as it was equal to the total gold stock under the gold standard. It is true of course that an individual member state, by acquiring a credit balance with the Union, may build up a reserve much larger than its quota. The international currency reserve of this country would then be its credit balance plus its quota. But since debit and credit balances cancel each other it still remains true that the aggregate of the quotas constitutes the aggregate of international currency.

In the theoretically conceivable case in which all countries expand their domestic currencies in step, while there is at the same time no disequilibrium in the balance of payments due to changes in reciprocal demand, the countries may indulge in inflation to any degree they wish. No debit and credit entries would then appear in the books of the Union. The sum total of the quotas would be irrelevant.[1] In fact, however, each country must take into account the possibility that its balance may become passive from time to time. The more the world price level rises the smaller a fixed quota will become in relation to the possible deficit in the balance of payments. This constitutes an ultimate check on world inflation. But, under the Keynes scheme, the quotas are not fixed but rise automatically with the aggregate value of international trade.

[1] The proposition that a given volume of international currency can support, under the conditions mentioned in the text, any degree of inflation, would also be true for an international gold bullion standard provided that gold cannot be withdrawn from the Central Banks except for export purposes.

Quotas and inflation can feed upon each other. The only check that then exists is that, since the quotas are based on a three-year or five-year running average of exports and imports, the increase in the quotas lags behind the increase in prices. But, for the first years after the war, when we can expect international trade to rise faster than world production, this check will not be strong, if, indeed, it exists at all. One may argue that these inflationary possibilities are of no importance, alleging the fact that, in recent years, certain countries did not inflate although accretions to their gold stocks would have permitted them to do so. Yet, if the experience of the period immediately following the last war is any guide, there is surely real danger of inflation in the years immediately following the present war. We shall see, moreover, that there is, under the plan, a certain pressure on countries with credit balances to get rid of them. One way of doing this would be to follow an inflationary policy.

Up to this point we have neglected gold. Gold does not, indeed, fit very well into the picture. One has the feeling that Lord Keynes worked it in for political reasons, realising that no plan has a chance of being adopted unless it guarantees the maintenance of the monetary use of gold. The stake which the United States and the British Empire have in gold is too powerful a force to allow its demonetization. But there is no doubt that gold is a nuisance rather than a help in the plan.

Since Bancor is the international currency, and since every country is equipped with a quota in terms of Bancor, there is no reason why a country should want to buy gold for monetary purposes. If a market for gold is to be created it must be made possible to exchange gold for Bancor. This is allowed for by the plan but its implications have, perhaps, not been seen and, certainly, not explored. Suppose the United States is willing to carry out an inflationary policy which, with fixed exchange rates, would make her balance of payments passive. The deficit would be covered by first acquiring Bancor against gold and then drawing on the accounts thus acquired in favor of the countries with active trade balances. If these are, at the moment, in debt to the Union they will now discharge their debts and it is quite conceivable that the Union will come out with Bancor balances entirely covered by gold. This would of course amount to a redistribution of the United States' gold stocks. But the point to be stressed here is that each country would now have, as its reserve of international currency, Bancor balances backed by gold and, in addition, its quota. An inflationary policy on the part of the United States would also raise the total value of international trade, thus tending to increase the quotas. It can be seen from this example that the monetary reserve of all countries, taken together, is actually the total monetary gold stock (which increases yearly by gold production) plus the sum total of the quotas (which increases with international trade). The introduction of gold into the plan thus makes it still more inflationary than it would be without any use of the metal.

It should be added that the plan provides some checks against the inflationary possibilities inherent in it. Thus it is stipulated that:

a) The gold price of Bancor can be changed. The purpose of raising the gold price of Bancor would be to effect a decrease in gold production, and to cut down the volume of Bancor which the holders of gold stocks could obtain from the Union in exchange for gold.

b) A country accumulating a credit balance in Bancor can be made to pay one per cent per annum on the amount of its average balance in excess of one-quarter of its quota, and another one per cent on the amount of its average balance in excess of one-half of its quota. The context in which these charges are suggested refers to credit balances to which debit balances of other countries correspond. If they also hold for balances that are covered by gold they would amount to a tax on the gold which is exchanged for Bancor deposits. It is hardly worth while to speculate about the influence which such a tax would have on the market for gold.

c) The Board can reduce the quotas, by a specified proportion of the full quota which will be the same for all countries, "if it seems necessary to correct in this manner an excess of world purchasing power." Such a reduction is, however, a dangerous weapon. Those countries which have only a small margin of their quota left may lose this margin altogether and may have to take deflationary steps to make their balance of payments active. The effect of the reduction of the quotas is comparable to the effect of raising the reserve requirements for member banks. Just as in that case an individual member bank with insufficient excess reserves may run into difficulties, so a country which is left with an insufficient margin of its quota may find itself in trouble.[1]

If gold production is large enough, or the United States is willing to follow an inflationary policy with the results indicated previously, it is quite conceivable that the quotas would have to be reduced to zero, in which case the plan would be automatically suspended and replaced by the gold standard.

In conclusion on this point we may say that the plan works in such a way that there can never be a shortage of international currency but that there can be an excess of it. The inflationary tendency of the plan can be

[1] The plan provides that no country will have to cut down its actual debit balance. But the disappearance of the margin left for further drafts on the Union might itself be sufficient to force the country to take deflationary measures.

combatted, but the most efficient way of doing it, the reduction of quotas, is a weapon which may cause considerable disturbance.

While Dr. White evidently did not intend to make any contribution to the solution of the problem of the volume of international currency his plan has certain implications in this direction which must now be brought to light. Under the White scheme the volume of international currency seems at first sight to be identical with the volume of monetary gold. It is true that a country may acquire Unitas deposits by depositing gold, and may draw on these deposits to settle differences in the balance of payments, but, since Unitas deposits must be covered 100% by gold, they do not constitute an addition to the reserves of international currency at the disposal of the countries concerned. A closer examination, however, throws a different light on the matter. The plan (III, 4) provides that each country has a right to purchase, with its local currency, such foreign exchange as is necessary to meet an adverse balance of payments on current account. It is therefore clear that each country may consider itself as being in possession of foreign exchange to the extent of its quota. A member state can therefore act like a country on the gold exchange standard, i.e., it can (and those countries without gold must) view this claim to foreign exchange as part of its reserve of international currency. The White plan therefore extends the international currency reserves, just as does the Keynes plan, by the amount of the quotas. The only difference is that the White plan does not envisage an automatic expansion of the quotas, nor does it mention the possibility of a change in the price of gold in terms of Unitas. The quotas, however, can be reduced by the Board just as under the Keynes scheme. The White plan, too, could function without any gold whatsoever so long as the countries have the right to buy foreign exchange from the Fund. There is therefore, on this score, no fundamental difference between the two schemes.

## IV. DISEQUILIBRIUM IN THE BALANCE OF PAYMENTS

UNDER the Keynes plan the Central Bank of a country with a passive balance of payments could sell checks drawn on the Union, with the result that this country would acquire a debit balance (and the countries with active balances of payments a credit balance) with the Union. As was pointed out above, the economic phenomenon reflected by these book entries is that of a short term loan: the countries with the credit balances would in fact lend to the country with the deficit the monetary equivalent of the commodities making up the latter's import surplus.

The deficit in the balance of payments of any country can clearly not go on forever. First there are certain counteracting forces which work automatically. It is not difficult to see that the selling of checks drawn on the Union by any Central Bank would lead to a corresponding decline in commercial bank deposits, to an equal decline in the deposits of the commercial banks with the Central Bank, and to a consequent reduction in their reserve ratios, and that the opposite movement would take place in the country which built up a credit balance. This corresponds exactly to what happens in the case of an outflow or inflow, respectively, of gold under the gold standard. Under both systems, when, at least, the banks have no excess reserves, the result is an automatic tendency to deflation in the debtor country and to inflation in the creditor country, tendencies which may, however, be counteracted by open market operations on the part of the Central Banks concerned.

The Keynes plan, furthermore, envisages a kind of psychological pressure toward inflation on the countries with credit balances. These balances cannot be withdrawn in the form of gold. Unless, therefore, a country is content to lend to the debtor countries for an indefinite length of time, it will have to follow an inflationary policy in order to get rid of the credit balance to which the debit balances of other countries correspond.[1] (The tax on credit balances, to be discussed later, will make itself felt in the same direction.)

The author of the plan, however, does not solely rely on automatic forces to check inflation or to balance accounts. He provides a procedure of tightening the screw in order to force the creditor and debtor countries to bring their balances in order. The main steps are as follows:

(1) A member state with a debit balance shall pay, into the Reserve Fund of the Union, 1% per annum of its average debit balance in excess of one-quarter of its quota, and another 1% on the balance in excess of one-half of its quota. The same applies to the creditor country. As far as the country with the debit balance is concerned this charge could be effective only for psychological reasons. An international loan at 1% would still be cheap. Nor does the charge seem high enough to induce the creditor country to take steps to reduce its active balance of payments unless, again, psychological forces determine its action.[2] The countries concerned, moreover, whether debtor or creditor, can avoid these charges. After consultation with the Board a debtor country

[1] Economically there is not much difference between receiving gold and keeping it indefinitely, on the one hand, and giving credit for an indefinite period on the other. But psychologically the difference is considerable.

[2] The proposal to put a 1% tax on the balances of the creditor countries is a feeble attempt to apply in the field of international finance Silvio Gesell's idea of taxing cash balances.

(through its Treasury or Central Bank) can borrow Bancor directly from a creditor country, an operation which simply involves the cancellation of both debt and credit items on the books of the Union. If countries avail themselves of this opportunity, the debtor country will be in a position to start, all over again, drawing against its quota. Furthermore, there is nothing to prevent the debtor country from raising its discount rate and thus attracting private foreign funds.[1] All these measures would postpone the adjustment in the balance of payments.

On the whole the Keynes plan would seem to lead to more short-term lending than does a gold standard. We have (a) the "automatic" lending through the Union, (b) the additional lending which occurs in case an agreement is reached between Central Banks in order to avoid the charges of 1%, and (c) we may have private lending as a result of a change in the interest rates. Under the gold standard the "automatic" lending would not exist nor would there be the pressure (in the form of a tax) on the several countries to come to a direct loan agreement. The tendency toward large short-term capital movements is at first sight a strange result of the plan, considering that its author is on the whole opposed to them. Since, however, the apparent idea of the plan is to avoid as long as possible the taking of steps which are necessary to adjust the balance of payments, this result is, perhaps, not so surprising as at first appears. There would seem to be little justification for a policy which tries to postpone the adjustment in the balance of payments. The measures which must be taken, once the adjustment can no longer be delayed, must be correspondingly severe and will thus create more painful disturbances than would otherwise be necessary.

(2) If the debit balance of a country has, for more than two years, exceeded one-quarter of its quota, the debtor country may devalue its currency by as much as 5%, but it may not repeat this procedure unless it has the consent of the Board.[2] If the debit balance is in excess of one-half of the quota the Board may *require* devaluation. The idea is, of course, to prevent the deflationary pressure that would otherwise be necessary. To these provisions there are two objections:

(*a*) The possibility of devaluation is made dependent on the fact that the average debit balance has been in excess of one-quarter of the

[1] It is true that the author of the plan looks askance at short-term capital movements of the "unwanted" kind and suggests their control by the member states. But the plan does not force such a control on the member states and the capital movements mentioned in the text can hardly be called "unwanted." We therefore assume the absence of the control of capital movements until we take up the problem more fully in Section V.

[2] Since other states may feel that their interest is injured by the devaluation of any currency they will be unlikely to give their consent except on being threatened with unilateral action on the part of the state concerned.

quota for at least two years. It would seem more desirable to make it dependent on the *increase* of the debit balance. If the debit balance has been in excess of one-quarter of the quota for more than two years, but is no higher at the end of this period than it was at the beginning, then the balance of payments has been in equilibrium for two years. If the currency is now devalued, it will no doubt be undervalued, and other countries may well complain about "exchange dumping." Only a *rising* debit balance indicates a continuing deficit in the balance of payments. The devaluation therefore should take place while the debit balance is increasing.

(*b*) As soon as the market begins to think (on the basis of a country's debit balance with the Union) that this country is going to devalue its currency, speculation against that currency will set in. There is no risk whatsoever involved in such speculation since the exchange rates are fixed up to the time when the devaluation takes place. As long as they are "fixed," they cannot move even as much as they did under the gold standard, since gold shipments are not required to cover a deficit in the balance of payments and gold points therefore do not exist. The Keynes scheme, in consequence, simply *invites* short-term capital movements. The author, it is true, suggests a control of them, without, however, making such control an integral part of his scheme. We shall later indicate that the introduction of the control of capital movements is no easy or pleasant matter. In view of this fact, it seems more reasonable to provide from the outset that the value of a currency in terms of Bancor will be allowed to fluctuate within certain limits. This could be achieved by a device which would correspond to the widening of the gold points under the gold standard. The Central Banks would be permitted to establish a differential in the buying and selling prices of Bancor drafts. Speculation against a currency would then no longer be riskless, and the speculators could from time to time be squeezed by appropriate action on the part of the Central Banks.

(3) Instead of, or in addition to, requiring devaluation by a country, once its debit balance is in excess of half the quota, the Board may ask the country to introduce the control of outward capital movements.[1] The implications of this provision will be discussed in Section V.

(4) If a country's debit balance is in excess of one-half of its quota the Board may *recommend* "internal measures affecting its domestic economy, which may appear to be appropriate to restore the equilibrium of its international balance." But only if the debit balance remains in excess of three-quarters of its quota for at least a year, or else rises at an

[1] The Board can also require the surrender of gold or foreign exchange by the country concerned.

excessive rate, can the Board *ask* that such measures be taken. This shows clearly that recourse to deflationary measures is viewed only as a last resort. Its function seems to be mainly to prevent a country from *relying* on the possibility of repeated devaluations. If this easy way out (easy, that is, for the devaluing country though not for the others) were *guaranteed*, we might expect a domestic monetary policy, on the part of any member state, which more or less entirely disregarded the effect of its monetary measures on international trade. This might readily lead to rather frequent changes of foreign exchange rates, with the result that the situation would not differ greatly from that prevailing in the decade immediately preceding the present war. Even with the scheme as it is, no one could be surprised to find that, in a period of strain, events developed in a fashion similar to what happened in those years. The Board, which is not equipped with any power to enforce its decisions (there are no sanctions provided in the plan), would probably have to consent to devaluations, *willy nilly*, just as the countries included under the tripartite agreement had to consent to devaluations of the French franc because there was not much that they could do to prevent them. The fact that countries can be declared in default would hardly be sufficient to keep them in line. The effect of such a declaration would be to prevent the country concerned from continuing to draw on the Union. But the declaration would only be made in a situation in which a country had practically exhausted its quota so that it could not in any case draw on the Union.[1]

The procedure to be followed under the White plan, when a disequilibrium in the balance of payments occurs, is fundamentally the same as under the Keynes plan. A country with a deficit balance has the right to buy foreign exchange from the Fund (provided it is used to make up a deficit in the balance of payments on current account) to the extent of its quota. This corresponds, of course, to drawing on the Union under the Keynes scheme. As soon as the Fund has acquired local currency of a country in excess of the latter's quota (it must be remembered that only 50% of the quota is paid in) this country has to pay to the Fund, in gold, 1% per annum on the excess. After a transition period of two years, the Fund can, with the consent of the Board, sell foreign exchange to the country concerned even if it already holds 200% of that country's quota in the form of the latter's currency. The Fund can then require that the country take steps to restore the equilib-

[1] The plan also provides that a country with a *credit* balance above a certain minimum shall discuss with the Board certain measures such as monetary expansion at home and reduction of tariffs. But, since the creditor country retains the right to make the final decision, such discussion is not likely to be very effective.

rium in the balance of payments. The steps taken may consist in deflation or devaluation. What has been said about Keynes' solution applies, on the whole, here also, and a detailed discussion is unnecessary. It should merely be noted that:

(*a*) The Fund has somewhat wider powers than the Union. It can influence the domestic currency supply in a member country: it can offer its own obligations for sale in that country (III, 1): or it can sell securities of the country, held by the Fund, in the market of issue. Provided the currency thus obtained by the Fund is held in the form of a balance with the Central Bank of the country concerned, such a policy will lower the reserve ratios of the member banks.[1] This method could be applied in a country with a passive balance of payments and the opposite procedure could be followed in a country with an active balance of payments. The deflationary or inflationary effects of this policy could of course be counteracted by the Central Banks of the countries concerned. In case of a conflict between the Fund and a Central Bank the Central Bank would almost certainly prove to be the stronger.

(*b*) The plan provides for the possibility of exchange rate fluctuations within specified limits (VI, 1). According to Sec. IV, 2, however, the value of the national currencies is to be fixed in gold or Unitas. If this is to be interpreted literally the exchange rates could show no appreciable fluctuations.

(*c*) The one important difference, in the present connection, between the two plans concerns the treatment of a country with an active balance of payments. When the Fund begins to run out of its holdings of the currency of a country (because this country has had an active balance of payments) the Fund can, as a last resort, ration such a currency among the other countries. No other interpretation can be given to the phraseology of Sec. III, 7 which says that "The Fund shall apportion its sale of such scarce currency. In such apportionment it shall be guided by the principle of satisfying the most urgent needs from the point of view of the general international economic situation. It shall also consider the special needs and resources of the particular countries making the request for the scarce currency." This means that in such a situation foreign exchange control is introduced by the Fund whereas its avowed purpose is to get rid of such control. There appears to be no reason whatsoever for such a provision. The thing to do would be to force the

[1] This should not be confused with the automatic effect which arises if the monetary authority of a country buys foreign exchange from the Fund and sells it to its importers. Such action also tends to lower the reserve ratios of member banks provided the Fund holds the local currency thus acquired in the form of a balance at the Central Bank of the country concerned. What happens here corresponds to what happens under the Keynes scheme when a Central Bank sells checks drawn on the Union.

country whose currency becomes scarce to resort either to inflation or to appreciation of the exchange value of its currency, which are the logical counterparts of deflation and depreciation, respectively, which the plan envisages in the case of a country with a deficit in its balance of payments.

(*d*) The Fund will tend to accumulate "weak" currencies and lose the strong.[1] If a devaluation of "weak" currencies, i.e., currencies of countries with passive balances of payments, takes place, the Fund will incur losses. To guard against such losses the White plan provides (IV, 4) that the country whose currency is devalued must deliver to the Fund, when requested, an amount of its local currency sufficient to make up for these losses. This additional currency can simply be created by the Central Bank of the country concerned and it has, therefore, nothing to lose by devaluation. No such manipulations are required under the Keynes plan but the result is much the same.

If the devaluation of the exchange value of a currency is just sufficient to bring the balance of payments into equilibrium, the Fund will cease to acquire additional currency of the country which had the passive balance but it will not get rid of the currency already accumulated. Correspondingly, some other currency or currencies will remain scarce among the assets of the Fund. Thus it may easily happen that the Fund will tend to be permanently loaded with certain currencies and to be short of others. To avoid this, the degree of devaluation of the "weak" (or the appreciation of the "strong") currency would have to be such as not merely to bring the balance of payments of one country with the rest of the world into equilibrium, but to make it active where it was previously passive and passive where it was previously active.

It is a disadvantage of the White plan that it creates a high degree of uncertainty for the monetary authorities of the member countries. The Fund *may* try to curtail the domestic money supply in a country, it *may* ask surrender of gold and foreign exchange in excess of the amounts the country had when joining the Fund (III, 8), it *may* place conditions on the sale of foreign exchange to a country even before the latter has bought foreign exchange to an amount equal to its quota, it *may* devalue the currency of a country. A Central Bank will find it difficult to administer its monetary policy if it has no way of knowing what will be the reactions of the Fund to any of its measures.

Summarizing, we may say that the procedure envisaged by the two plans, in the case where a country has a passive balance of payments with the rest of the world, is intended to avoid deflation in the country concerned (a) by bridging the gap, as long as possible, through the grant-

[1] I am indebted to Professor Frank D. Graham for this point.

ing of short term credit (b) if this is not sufficient, by controlling outward capital movements, and (c) by devaluation. Devaluation is to be the main method of adjusting a fundamental disequilibrium in the balance of payments. There is no device in the plans which could effectively prevent a member state from following a monetary policy leading to such a fundamental disequilibrium, nor is the Board strong enough to prevent a devaluation if a member state insists on it. The situation, in times of crisis, would therefore not be fundamentally different from that under the tripartite agreement before the war.

## V. CAPITAL MOVEMENTS

We have seen that the Keynes plan (and the same is true, though to a lesser degree, of the White plan) will tend to increase short-term capital movements as compared with what they would be under the orthodox gold standard.[1] Keynes strongly favors the idea that the member states should control these movements. Indeed the success of the plan will largely depend on the possibility of controlling speculation against a currency which is expected to be devalued. Keynes, however, does not try to enforce such a control upon the member states, except that the Board may require it from a country which has a debit balance in excess of half of its quota. The White plan goes a little farther. The provision that a country has a right to buy from the Fund foreign exchange up to an amount equal to its quota, provided this exchange is used to meet an adverse balance of payments on *current account*, implies that foreign exchange dealings are concentrated in the hands of a central authority from which the purchasers must buy their foreign exchange on application stating for what purpose the exchange is needed. The White plan would therefore function only with complete registration of foreign exchange dealings. This is the first step in the direction of foreign exchange control. It creates red tape, delay, annoyance. But it is still conceivable that the authority could give a general permission for all purchases on current account but reserve the right to grant, or refuse, foreign exchange for the purpose of capital export. Such a policy is suggested in the Keynes plan.

Now it is well known that a country which tries single-handed to control capital exports is confronted with almost insurmountable difficulties. It is not sufficient to deny foreign exchange to those who want to shift their capital abroad. It is also necessary to control exports. If out-

1 The problem of long-term capital movements is not discussed here. Keynes advocates an international lending institution. A discussion of this problem must wait until the details of the plan are known.

right capital movements are forbidden there is always a tendency to export all kinds of things which would otherwise not be exported (from jewelry to rare stamps) simply in order to build up balances abroad. All exporters would have to be compelled to report to the central authority all of the foreign exchange that they acquire. They could not be permitted to leave the proceeds of their exports abroad without proving that they do it for good business reasons and not because they expect a devaluation of their domestic currency. They could not even be permitted to extend their terms of credit without such proof. Under such circumstances the temptation is great not to register the acquisition of foreign exchange at all, particularly since the exporters know better than anybody else that it is almost impossible for the central authority to check on them. It is just as difficult to check on the applications of importers for the purchase of foreign exchange. To trust the honesty of the importers, who in any case feel annoyed by the clumsy and slow procedure to which they are subjected, does not seem to be very realistic. The experiences of those countries which have made the attempt to control capital movements indicate that a comprehensive system of foreign exchange control, interfering greatly with international trade, is an almost inevitable outcome.

The control of capital exports would be made easier if it were supported by a control at the receiving end. This is suggested by Keynes and the White plan makes such cooperation on the part of the receiving country obligatory. But even then the use of undercover agents and numerous devices which, in such circumstances, are invented in great variety by the imaginative business world, would make capital exports possible though they might be smaller than if they were left free. But, against this, we must set serious disadvantages of which two seem to be particularly important.

First, there is the undermining of business ethics. This is the inevitable result of restrictions which interfere with the smooth functioning of trade and which, moreover, can never be administered in a perfectly fair way. Secondly, once the apparatus for foreign exchange control exists in the form of complete registration of foreign exchange transactions, it would be surprising if the authorities did not sooner or later make use of it for the control of foreign exchange transactions on current account. (It is, for the moment, assumed that it is possible to combine control of capital movements with a general permission for exchange transactions on current account.) This would, of course, be against the intentions of the two plans. But the temptation is great. Experience seems to show that governments are rather strongly disposed towards exchange control. It is so very convenient to use it for protective purposes or for effectively discriminating against some unfavored country.

Furthermore, a country with a deficit in the balance of payments might easily prefer foreign exchange control to devaluation. It benefits from the latter only if there is unemployment in the country. If full employment exists it may appear that a devaluation merely makes the terms of trade less favorable for the country without any compensating benefit in the form of an increase in employment. In this situation it is tempting to avoid devaluation and to resort to foreign exchange control. If the apparatus for the control already exists the temptation may be too strong to be resisted. To make complete registration of foreign exchange dealings a part of the plan seems therefore a dangerous procedure which may easily lead to a reintroduction of the full foreign exchange control which it is the purpose of the plans to abolish.

The only sound method of preventing short-term capital movements of the speculative and political kind is to remove their causes. So far as capital movements undertaken for political reasons are concerned, they will depend on the degree of political stability that is achieved after the war. Nothing can here be said about that. As regards speculative capital movements we may either resign ourselves to the fact that it is impossible to restore an atmosphere in which no country dreams of touching the foreign exchange rates, or we may, as a matter of principle, prefer fluctuating exchange rates to fluctuating price levels. In either case it seems advisable (for the reasons given above) to establish a margin within which the rates can change rather than resort to sudden devaluations and to the control of capital exports.

## VI. PROBLEMS OF THE TRANSITION PERIOD

Both plans have considerable merits as methods for dealing with the difficulties which will arise in the period of transition to more stable conditions. As far as the now frozen short-term balances are concerned the White plan provides, and the Keynes plan suggests, a procedure according to which the Fund (or the Union) shall take over the balances in exchange for Unitas (or Bancor). The Fund (or the Union) will then liquidate them over a period of time. The details (given in the White plan) need not here be discussed.

The other problem which arises out of the expected heavy demand for imports, on the part of practically all countries except the United States, is solved by giving those countries reserves of international currency, in the shape of their quotas, on which they can draw to finance their purchases. Whether the quotas proposed are sufficient to bridge over the transition period is difficult to tell.[1] Much depends on the foreign exchange rates chosen. Neither plan suggests criteria for such a choice. Keynes seems to rely on a method of trial and error, allowing rather frequent changes in the exchange rates in the first five years after the war. The chaos in foreign exchange rates which prevailed after the last war would, however, be avoided. If the plan is adopted we shall witness unstable (though not chaotic) exchange rates for a considerable period after the war, combined with a gradual lifting of foreign exchange control. All through this period the United States seems likely to build up credit balances in the Union whereas most other countries will run into debt.

## VII. CONCLUSIONS

LEAVING minor points aside our discussion has shown that:

(1) The Keynes plan has a strongly inflationary bias which could be removed in part by not allowing the quotas to rise automatically with international trade;

(2) Gold is quite unnecessary or even a nuisance under both schemes;

(3) The control of capital movements suggested by the plans is likely to lead into comprehensive foreign exchange control even for transactions on current account. Instead of capital movements being controlled, it would seem better that the foreign exchange rates should be allowed to fluctuate within a certain margin as the White plan suggests;

(4) The Keynes plan, in particular, but the White plan also, shows a tendency to postpone inevitable adjustments in the balance of payments, with the result that, when the adjustment has ultimately to be made, it will be more painful than it would have been if made earlier;

(5) Not much can be done against devaluation by a member state if such a state insists on it. Economic sanctions would have to be envisaged if there is to be any chance of securing cooperation between the member states in times of crisis.

It is interesting to step back and to look at the plans as a whole. Unlike the classical economists, most modern economists do not favor solutions of economic problems which are based on principles. Instead they advocate, in each concrete instance, measures devised *ad hoc* which, if

[1] Great Britain would have an initial quota of approximately $5.5 billion. One-fourth of it, i.e., $1.4 billion could be used before the one per cent charge was levied. This may be compared with the figure of roughly $1 billion representing that part of the import surplus of Great Britain which used to be financed by the return on foreign investments. A large part of these investments has been liquidated during the war.

ingenious from a technical point of view, may contradict other measures devised in other fields. The result is that the pattern of economic policy of modern governments is far from being a model of logical consistency. (The influence of pressure groups accentuates this result.) Economic policy has indeed become so inconsistent that it hampers the working of the economic mechanism much more than it fosters it. What is true of economic policy as a whole is also true of its separate spheres. The two plans discussed in this paper are an illustration of the point. 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 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. The plans have great advantages for the period immediately following the war inasmuch as they provide reserves of international currency, for those countries which will need them to finance an import surplus, and offer a method of avoiding complete chaos in the foreign exchange market. They have, moreover, the merit of bringing before the public an important problem which deserves extensive discussion. But they do not give a solution which can be regarded as satisfactory for the long run.

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