

Post-War Currencies

By W. C. CLARK

AS constructive suggestions for the solution of the problem of monetary instability in the post-war world, three plans have recently been offered by American, British and Canadian experts.

They have a special interest for Canadians. First, we have a greater per capita stake than any other country in an active and healthily functioning world trade. Although our population is less than 12 million, we are today the third or fourth most important trading country in the world. Secondly, while the United Kingdom is normally Canada's best customer, Canada is normally the best customer—and also the largest debtor—of the United States. When, therefore, the American dollar-pound sterling exchange ratio is unstable, Canada gets "whip-sawed" between these two key currencies. When pounds sterling cease to be freely convertible into U.S. Dollars, as, from the beginning of this war, our lot may be hard indeed. Some means must be found of converting surplus sterling into American dollars. That, after all, is the main purpose of an international monetary system to ensure that the proceeds of a country's exports to another country can be spent freely for the purchase of goods in any part of the world.

The Objective

In the last analysis the fundamental or ultimate objective of all three plans is to make possible a form and measure of international collaboration which, along with other necessary collateral arrangements, will enable the world to solve the complex economic problems of the post-war period instead of merely repeating the disastrous errors and frustrations of the thirties. To facilitate the attainment of this ultimate objective, all three Plans recommend the setting up of an

international monetary organization which would have three main purposes.

Briefly stated, the Plans envisage that the participating countries are to agree together, through the new agency, on the exchange rates that they will adopt after the war; on the general nature of the circumstances under which and the procedure by which they will agree to alterations in such rates; and on the establishment of an international fund on which each member may draw up to specified amounts and subject to certain types of conditions at various stages, and which will serve to assist the member countries in maintaining a reasonable balance in their international receipts and payments. The new agency, however, is not to take the place of the ordinary foreign exchange market or of the ordinary international operations of commercial or other private banks; it is to deal only with or between National Treasuries or central banks, providing balances of foreign exchange required to maintain the equality of demand and supply on the exchange markets at the established rates.

Credit Facilities

The three Plans differ as regards the precise techniques to be used in providing these credit facilities and as regards the amounts which may be involved. The British Plan for an "International Credit Union" involves a simple and elegant application of banking principles to international transactions. The Union starts out without any funds whatever. Each country has a so-called "quota" in the Union which consists simply of a line of credit with the Union, entitling it to borrow up to specified amounts subject to certain conditions beyond specified points. This borrowing is to be done in terms of a new international currency which Lord Keynes calls "bancor". Quotas are assigned to the various countries on the basis of their relative impor-

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tance in international trade and these quotas determine not only the credit facilities available but also their voting power in the Union. The new agency is thus a bank without subscribed capital, creating its own funds, providing a new international currency (in a real sense), and using the "overdraft" principle. Each country's unused overdraft facilities in the Union constitutes for it the equivalent of a gold reserve.

The American or White Plan, on the other hand, follows the more orthodox principle of setting up an institution endowed with capital resources subscribed by its members. Each member country subscribes its quota and pays into the Fund gold and domestic currency or government securities, in specified proportions, equivalent in total to the amount of its quota. The quotas are expressed in terms of "unitas", a new international currency unit but merely a unit of account (meaning simply ten American dollars or gold to the value of \$10 at the present price), and are determined by a formula which takes into account the gold holdings of each country, its national income and the fluctuations in its balance of trade. Borrowing by a member will normally take the form of exchanging with the Fund an additional quantity of its own currency for the currency of some other country which the Fund has acquired as capital contribution or otherwise. Gold is thus supplemented from the point of view of deficit countries by the amount of the currencies of surplus countries available in the Fund. Under this Plan, a country's surplus on income account would show itself in the rate at which its initial subscription disappears from the Fund; if it had a deficit this would show up in an accumulation of its national currency by the Fund.

The Canadian experts who have been concerned with this problem have been able to see certain merits both in the "banking principle" which underlies the Clearing Union set-up and in the Fund principle which has been the normal technique used by Exchange Stabilization Funds in the past. One of the great mer-

its of the banking principle is its simplicity and neatness—its logical beauty. In this set-up, all real exchange transactions take place outside the Union between individual pairs of member countries and are merely reflected in the books of the Union through transfers of bancor balances from one country to another. The Stabilization Fund, on the other hand, is a real fund, consisting of a mixed bag of currencies; it is therefore more complicated and will involve more active day-to-day management.

To the Canadian experts these differences are technical rather than fundamental. The really vital differences relate to the nature of the commitments assumed by member countries and the magnitude of the resources made available. Under the Keynes Plan, no upper limit is placed on the commitment of any country to put up its national currency in exchange for transfers of bancor balances to its credit on the books of the Union. On the basis of the formula suggested by Keynes, the sum of the quotas assuming all countries joined the Union, would be \$36 billion. The Canadian experts came to the definite conclusion that even the appearance of an unlimited commitment would make any currency plan politically unacceptable in certain countries, particularly this country. Accordingly, they followed the American model of creating a Fund with initial resources provided by capital subscription, but with important differences in detail, particularly in regard to the size and composition of the Fund. They believe that the Fund to be established should be large enough to give all countries a real breathing space after the war; large enough to give them time to go about their tasks of reconstruction and industrial re-equipment without having to consider wholesale import restrictions, export subsidies and similar measures in order to make both ends meet on international account; large enough to command general confidence in its stability; and large enough to provide real support to countries which are temporarily short of foreign exchange as a result of crop failures or other contingen-

cies beyond their own control. Accordingly, the Canadian plan provides the Fund with potential resources of at least \$12 billion as contrasted with a "minimum of \$5 billion" in the American or White plan.

Only experience itself, however, (if it is given a chance) will demonstrate how large the Fund should be but the Canadian experts are convinced that the American suggestion involves too small a fund and the British an unnecessarily large one.

Exchange Rate Stability

The second of the main purposes involved in the Plans is the stability of exchange rates and an orderly procedure for their determination. The importance of stable exchange rates as a factor in facilitating the healthy functioning of international trade or in providing a necessary basis for international investment cannot be overemphasized. There are those, however, who decry the setting up of any such new international agency as the three Plans contemplate and who place their faith in what seems to be the forlorn hope of the voluntary restoration of the traditional gold standard by all the leading countries. Whether we like or not, it is mere day-dreaming, as Professor Viner emphasizes, to assume that if only the United States returns to a rigid full-fledged gold standard, the rest of the world will follow or, failing this, will peg its currencies to the dollar, so that either a world-wide gold standard or a world-wide gold-dollar standard will prevail. Many countries, as he points out, will emerge from the war period with shattered or distorted economies, and, most important of all, many countries will be unwilling to accept the rigid commitments and discipline which adherence to the gold standard implies. Full employment has become too firmly imbedded as an objective of social policy to make possible the adoption of a monetary policy which in return for the benefit of rigid exchange rates would allow some blindly automatic force to subject the domestic economy to alternate bouts of inflation on the one

hand and of deflation and mass unemployment on the other hand.

Similarly the advantages of an orderly procedure for determining, and a system for maintaining reasonable stability in, exchange rates do not seem to be fully appreciated by those who offer the so-called "key currencies" approach to a solution of these problems. This approach would involve an arrangement under which the central banks of the key countries would agree to provide each other with the resources necessary to protect their exchange rates at agreed levels. They would agree to accumulate and hold deposits of each other's currency within whatever limits were originally agreed. There is merit in this approach but it appears to accept the splitting up of the world into a sterling area with a group of satellite countries revolving around Great Britain and a dollar area with a group of satellite countries revolving around the United States. But it is not enough to stabilize only the key currencies or to apply an international code to them alone. Many countries which are not included amongst the Great Powers are still of importance—not only to one another but to the major powers.

In contrast with the automatic gold standard or the "key currencies" alternative, all three Plans recognize that the exchange rate of any country is properly a matter of international concern, provide a mechanism or procedure by which agreement among nations will be reached in regard to the determination of initial rates, and except under certain conditions remove from member countries the unilateral right to change their exchange rates at will. This latter involves some apparent sacrifice of sovereign rights but so does every association of nations or individuals for a common purpose. The present versions of all the Plans recognize that exchange rates should initially be fixed with the agreement of the country concerned. This appears to be realistic since no country is under obligation to join the Fund, and no country which feels that the exchange rate fixed by the Fund is inappropriate will join. Obviously, in

view of the difficulties in determining on the basis of any *objective* criteria the appropriate initial rates of exchange some provisions must be incorporated in the Plan which will provide a reasonable degree of flexibility, particularly in the early years.

In this respect, also, the Canadian Plan occupies middle ground between the Keynes and the White Plans. The latter, in its amended form, still provides for a higher degree of rigidity of exchange rates than either of the other two Plans. Except in the case of occupied countries which are to fix an initial rate in consultation with and acceptable to the Fund, the rates initially used are to be based on the value of each member country's currency in terms of U.S. dollars on July 1, 1943. Changes in such rates will in general be considered only when essential to correct a fundamental disequilibrium in the country's balance of payments and must be approved by three-fourths of the member votes, including the country concerned. Under the Keynes Plan, a member country with a debit balance to the Union may under certain circumstances devalue its currency by 5% at its own discretion and, subject to the consent of the governing board of the Union, by more than 5% and on more than one occasion. If its debit balance reaches half of its quota, it may be required to reduce the value of its currency. The Canadian Plan provides that no country can change its initially agreed rates without the consent of the Union unless it has been a net purchaser of foreign exchange from the Union to the extent of 50% of its quota for two years, in which case it may devalue by as much as 10%. This concession, however, is not available to a country which holds independent official reserves of gold and free foreign exchange exceeding 50% of its quota, and no country can repeat the exchange depreciation provided for without the specific approval of the Union.

Maintaining Equilibrium

The third of the primary purposes of the new monetary agency is to be the provision of a method and mechanism for

securing the adjustments required to maintain equilibrium in the current account positions of member countries. In addition to the extent to which adjustments may be effected by alterations in exchange rates, other forms of remedial action are provided for in cases where member countries persistently incur either excessive deficits or excessive surpluses on current account. Under all three Plans, countries with chronic deficits receive only limited assistance designed to give them time to correct their basic positions and technical aid in doing so. Restraints of various kinds are imposed on borrowings by member countries beyond specified fractions of their quotas, the limitations usually taking into account not only current rates of increase in borrowing but also the duration of the indebtedness.

All three Plans recognize that surplus countries may be equally responsible with deficit countries for creating disequilibria in international exchange. For instance, major provisions of the Canadian Plan provide that when the Union's operations have resulted in net sales of the currency of any member to the extent of 75% of its quota, the Union may attempt to arrange with that country a program of capital investment or securities repatriation in order to increase its reserves of the currency in question. When net sales of a currency have reached 85% of a country's quota, the Union has the authority and the duty to render to that country a report analysing the causes of the depletion of its holdings of the particular currency and making recommendations in regard to monetary and fiscal policies, exchange rate, commercial policy and international investment, believed to be appropriate in order to restore the equilibrium of the international balances of the country concerned. When it finds it necessary to ration a scarce currency the board is required to re-examine prevailing exchange rates and recommend such changes as it may believe appropriate to the changed circumstances.

The philosophy behind all these provisions is the belief that it would be extreme-

ly dangerous to use short term credits as a service to cover up basically unsound positions. No debtor country can live beyond its resources indefinitely; and no creditor country can persistently refuse to lend its surplus abroad or make other adjustments to its creditor position without ripping the international fabric. Thus the provisions of the Canadian Plan which make possible a substantial volume of short-term credits are not intended to allow either debtor or creditor countries to avoid the painful correction of fundamental disequilibria, but merely to give adequate time for adjustments to be made and for remedial measures to have their effects.

The Place of Gold

All three Plans assume, explicitly or implicitly, that gold will continue to serve as a means of international payments; and as a gold-producing country Canada naturally has no quarrel with this assumption. The Keynes Plan places rather less emphasis on gold than either of the other two Plans and might facilitate a more fundamental departure from the traditional gold standard. Any member country may sell gold to the Union at a fixed price in bancor, but bancor is not freely convertible into gold and no country can demand gold from the Union. Moreover, no member country can purchase gold at a higher price than corresponds to the parity of its currency with bancor, and if its debit balance to the Union exceeds one-half its borrowing quota the governing Board may require the deposit of gold collateral and even the outright transfer to the Union of any gold it may own for the purpose of reducing the debit balance. Under the American and Canadian Plans, however, gold would be usable for all its traditional monetary purposes and in addition would have an internationally guaranteed monetary value. A four-fifths majority vote would be required to authorize a change in its monetary value. Member countries must pay a stated proportion, and may pay all, of their capital quotas in gold.

The practical effect of these and the other features of the two Plans is not to restore the old gold standard but to establish a new monetary system which will retain many of the advantages of that standard and avoid its well-known disadvantages—in particular its inflexibility and its blindly automatic character.

Allocation of Votes

The Plans contain detailed provisions for the allocation of voting strength as between the member countries. There is one point of principle which needs brief consideration. As indicated previously, the Canadian Plan requires a four-fifths majority vote to authorize an all-round change in the value of gold. This represented a recognition of the fact that the United States has here a dominant interest, both from the point of view of the value of American gold holdings and from the point of view of American gold buying policy. It is, however, the only concession made from the general principle that all decisions should be taken by a simple majority vote, whereas under the White Plan, certain important decisions, particularly those relating to changes in exchange rates after the first three years, require a three-fourths majority vote. To the Canadian experts the simple majority vote seemed to represent not only the democratic method but also the one best calculated to make member countries take their responsibilities seriously.

The Canadian experts recognize nevertheless that creditor countries will require assurance that the Union will not play fast and loose with their interests and not be run by an aggregation of debtor countries who will commit the Union to courses of action which the creditor countries may find intolerable. Their solution for this problem is the simple one that a country which has not been a net purchaser of exchange from the Fund should be at liberty to withdraw at any time by giving thirty days' notice, instead of one or two years' notice as suggested in the American and British Plans, without assuming any new responsibility in the interval. Under

any formula, success will depend on co-operation and a reasonable measure of give and take, and it seems reasonable to provide that a country which finds its position intolerable can withdraw virtually at once, after a short cooling-off period.

Conclusion

One criticism has been directed against the Plans, particularly against the Keynes Plan, which has real merit and must be met. This criticism is perhaps best set forth in Imre de Vegh's critical analysis of the Keynes proposal¹. He points out that if the Clearing Union is put into operation immediately the war ends, it will release vast and highly inflationary credit facilities in a world which will be trying to counteract the inflationary forces created by war and the war's aftermath. Particularly on this continent and in the whole Western Hemisphere, the close of the war will probably see a huge volume of deferred demand for goods with accumulated purchasing power competing for a supply of civilian goods which will be short in many fields at least until reconversion of the economy to peacetime production has been fully effected. For a time, acute scarcities of many types of goods may exist side by side with a temporary surplus of labour. During the transition period, moreover, the interests of the rest of the world and particularly for Europe will require large exports from this hemisphere for the relief and rehabilitation of the liberated peoples and for the reconstruction of devastated areas. To make billions of "bancor" credit also available to the needy countries at the same time would add further to the dangers of inflation during the transition period as well as to the difficulties of handling the American economy during the later period when the change-over from an export surplus to an import surplus will be required. Mr. de Vegh recognizes that these dangers would add further to the dangers of inflation during the transition period as

well as to the difficulties of handling the American economy during the later period when the change-over from an export surplus to an import surplus will be required. Mr. de Vegh recognizes that these dangers would be in direct proportion to the size of the funds made available through the new monetary agency. They would consequently be substantially less under the White and Canadian Plans than under the Keynes Plan because the credit facilities made available would be much smaller and based on member contributions to a central fund and because the provisions for lending are better safeguarded.

Mr. de Vegh reaches the conclusion that the time to organize such a Clearing Union would seem to be not at the beginning but at the end of the so-called reconstruction period, perhaps five or ten years after the end of the war. It is difficult to follow him this far, but it can be agreed that it would be desirable to control and, if necessary, to defer during the transition period access to some part at least of the credit facilities made available by the new monetary agency. In this way the potential danger which he fears could be avoided without sacrificing all the other advantages of the schemes. Time already presses, and, as the months pass, the driving force of hard necessity, the instinct for self-preservation, the lack of any basis for confidence in the possibilities of organized cooperation will more and more drive harassed and hard-pressed governments to follow selfish, restrictive, beggar-my-neighbour, unilateral or bilateral policies which will impoverish their own peoples and contribute to the impoverishment of the world. To meet that danger it is desirable to set up this new instrument of international collaboration as promptly as possible. Albeit subject to many limitations and weaknesses, it should provide a necessary weapon to promote conditions under which the cooperating countries may, in the present critical years and over the long-run future, be able to carry out sound economic policies for the welfare of their own people and the benefit of the whole world.

1. American Economic Review, September, 1943.