INTERNATIONAL MONETARY FUND AND
MONETARY STABILITY

by

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STATEMENT BY AUTHOR

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ACKNOWLEDGMENTS

The period 1956 to 1958 brought to bold relief the foreign exchange difficulties experienced by the developing Indian economy. In that context Professor R. M. Howard, Head of the Department of Accounting, suggested that I write my thesis on the International Monetary Fund. I welcomed the suggestion, as at that time there was a growing dissatisfaction in financial circles in India that it was not getting enough benefits from the Fund though India was the fifth largest contributor to the Fund. But in view of the dearth of materials on this subject of India's relationship with the Fund, it was believed that a comprehensive survey could not be carried on. So I chose to write on the Fund and its activities in broad outline.

This would not have been possible but for the patience, careful direction, and erudition of Dr. William H. Fink, Department of Economics. For these and the long hours he expended, reading the draft, I offer him my most grateful thanks.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>CHAPTER</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td><strong>PART I</strong></td>
<td></td>
</tr>
<tr>
<td><strong>THE HISTORICAL DELINEATION</strong></td>
<td></td>
</tr>
<tr>
<td>I  GOLD STANDARD MECHANISM AND ITS COLLAPSE</td>
<td>4</td>
</tr>
<tr>
<td>II INTERNATIONAL MONETARY LESSONS OF THE THIRTIES</td>
<td>11</td>
</tr>
<tr>
<td>III  THE PROBLEMS OF MONETARY STABILIZATION</td>
<td>15</td>
</tr>
<tr>
<td><strong>PART II</strong></td>
<td></td>
</tr>
<tr>
<td>PLANS FOR INTERNATIONAL MONETARY COOPERATION</td>
<td></td>
</tr>
<tr>
<td>IV  THE ROAD TO BRETTON WOODS</td>
<td>21</td>
</tr>
<tr>
<td>V  A SYNTHESIS: THE INTERNATIONAL MONETARY FUND</td>
<td>28</td>
</tr>
<tr>
<td>Purpose</td>
<td>28</td>
</tr>
<tr>
<td>Organization and Structure</td>
<td>30</td>
</tr>
<tr>
<td><strong>PART III</strong></td>
<td></td>
</tr>
<tr>
<td>PROGRESS OF THE FUND</td>
<td></td>
</tr>
<tr>
<td>VI  THE EARLY YEARS OF CRISIS</td>
<td>33</td>
</tr>
<tr>
<td>International Economic Situation</td>
<td>34</td>
</tr>
<tr>
<td>Assistance from the Fund</td>
<td>40</td>
</tr>
</tbody>
</table>
TABLE OF CONTENTS (cont'd)

<table>
<thead>
<tr>
<th>CHAPTER</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Par Values and Exchange Stability</td>
<td>42</td>
</tr>
<tr>
<td>Exchange Restrictions and Multiple Currency Practices</td>
<td>43</td>
</tr>
<tr>
<td>Convertibility</td>
<td>48</td>
</tr>
<tr>
<td>France Ignores the Fund's Decision</td>
<td>50</td>
</tr>
<tr>
<td>Series of Devaluations</td>
<td>54</td>
</tr>
<tr>
<td>Exchange Restrictions after the &quot;Transition&quot;</td>
<td>58</td>
</tr>
<tr>
<td>European Payments Union</td>
<td>60</td>
</tr>
<tr>
<td>VII</td>
<td>IS THE TRANSITION OVER?</td>
</tr>
<tr>
<td>PART IV</td>
<td>THE ROLE OF THE FUND IN STRENGTHENING INTERNATIONAL ECONOMY</td>
</tr>
<tr>
<td>VIII</td>
<td>SUMMARY AND CONCLUSIONS</td>
</tr>
<tr>
<td>Attempts at International Monetary Cooperation</td>
<td>74</td>
</tr>
<tr>
<td>The Economic and Financial Conditions During the Early Years of the Fund</td>
<td>76</td>
</tr>
<tr>
<td>Progress of the Fund: Exchange Stability</td>
<td>76</td>
</tr>
<tr>
<td>Exchange Restrictions</td>
<td>78</td>
</tr>
<tr>
<td>Convertibility</td>
<td>80</td>
</tr>
<tr>
<td>The Fund's Exchange Operations</td>
<td>81</td>
</tr>
<tr>
<td>Case for Increased Resources</td>
<td>85</td>
</tr>
<tr>
<td>Fund Represents A Valuable Cooperative Element</td>
<td>86</td>
</tr>
<tr>
<td>BIBLIOGRAPHY</td>
<td>89</td>
</tr>
</tbody>
</table>
INTRODUCTION

The problem with which this study concerns itself is an assessment and analysis of monetary stability and the subsidiary agency of the United Nations--THE INTERNATIONAL MONETARY FUND (IMF)--a device of the post-war world designed to achieve this. This institution was born along with its twin institution, the International Bank for Reconstruction and Development (IBRD), as a result of the Bretton Woods Conference which was attended by 44 nations at Bretton Woods, New Hampshire, July, 1944.

The IMF epitomizes the spirit of our age--because a new age required the formulation of a new philosophy and a new institutional framework. In an age of internationalism, the exercise of national sovereignty is fraught with great dangers. Whether in the political or economic sphere, we are faced with national policies dictated with reference to their self-interests conflicting with the needs and requirements of our time. In this context, it is a platitude to repeat that we must either plan or perish.

Obviously, therefore, the economies of the world are to be subjected to some external discipline so that the objectives of the well-being
and continuous prosperity of all nations can be achieved. The fields of foreign exchange and international payments have hitherto been looked upon by the sovereign nation-states as their unquestioned provinces, and policies affecting these have been moulded by the governments solely with reference to narrowly conceived national interests. Nevertheless, the devastation and destruction brought about by the world wars and the consequences of the world-wide depression of the thirties have forced the realization on the nations of the world that the well-being of all countries depends on the policies that each pursues in matters affecting the world economy. As a result, the need for an international organization to assist in the determination and maintenance of equilibrium rates of exchange and to settle the international payments was recognized. Various institutions were, therefore, conceived and set up after the war to achieve monetary stability, orderly economic growth, and steady progress.

To the nations mapping peace-time reconstruction at the end of World War II, the international monetary disruption and conflict of the 1930's and 1940's were bitter memories. There was little sentiment for restoring the old gold-standard mechanism which R. G. Hawtrey calls a state of "anarchy in world credit control." But there was widespread

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agreement on the necessity for restoring reasonable exchange stability and for lessening the restrictive, discriminatory exchange controls prevalent before and during the wars. (The IMF was established in the hope of achieving what was thus widely agreed on.) In this thesis, it is set in the historical perspective. The latter day economic and monetary developments are also traced to show the success achieved by the Fund.

The sources and materials used for this survey are the official documents of the IMF and other Governments, operational reports, articles from the influential economic journals, books, and reports by experts in this field.
PART I

THE HISTORICAL DELINEATION
CHAPTER I

GOLD STANDARD MECHANISM AND ITS COLLAPSE

An excursion into the pre-1914 period and a recapitulation and evaluation of the mechanism of the gold standard, the predecessor of the International Monetary Fund, is perhaps the best prelude to the study of the latter institution. The gold standard mechanism was a natural evolution and was fairly successful in equilibrating the 'ever changeable' developments of the international balance of payments. This mechanism, a semiautomatic system, was the world's nearest approach to a system of international monetary equilibrium. Its essence was the correspondence of domestic money supply changes to international gold flows. In the world of the last third of the 19th and the first third of the 20th century, where each independent nation fancied that sovereignty was its most prized possession, it flattered their national ego not to have to pay homage to a man-made institution, though it was not realized by them that to observe the rules of the gold standard game was in reality to surrender part of their sovereignty to the dominant nation, i.e., England.

An understanding of the nature, operation, and collapse of this system would further explain and confirm the foregoing.
The gold standard game presupposes that the member countries are 'on gold.' The national monetary units are defined in terms of weight units of gold, and through the medium of gold the exchange rates are fixed. Under these conditions gold is the world's common unit of value, an international means of payment, and a money reserve of international liquidity.  

The legal requisites for a gold standard are that the Central Banks or treasuries of member countries must be willing to buy and sell unlimited amounts of gold at fixed prices; these prices must be practically the same for purchases and sales; moreover, free import and export of gold bullion or coins must be permitted. In principle, the "classical" way in which the gold standard worked in its hey-day before 1914, as described by the Cunliffe Committee, is delightfully simple.

If a country develops an appreciable balance of payments deficit, it is settled by a flow of gold out of the country. Similarly, a surplus country will receive a gold inflow.

At this point comes the essential link in the chain: the banking mechanisms of countries operating the standard according to the classical rules should be such that a gold inflow leads to an expansion in the total monetary circulation, while a gold outflow leads to a contraction. The change in the monetary circulation occurs at two points: the change in the quantity of legal tender money, and the change in the amount of

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deposits at the commercial banks.\(^1\) This can be seen if we consider, say, the country with a balance of payments deficit, which is losing gold. Importers pay for the import surplus by buying foreign exchange from their banks; their banks get the foreign exchange by buying gold from the central bank and exporting it. The public's deposits at the commercial banks and commercial banks' cash reserves at the central bank fall by equal amounts bringing down the reserve ratio of the former. In the ideal gold standard system, excess reserves of the commercial banks are at a minimum; therefore, in the new equilibrium they must make multiple cuts in their investments and advances, and so in their deposits. Similarly, there will be a multiple expansion in the quantity of money in a country which is receiving gold if its commercial banks are maintaining constant reserve ratios.

The contractionist policies which depend at least partly on a conscious effort on the part of the central bank will raise the rates of interest in the gold-losing or deficit country, while, on the other hand, the rates of interest in the gold-receiving country will fall. The different interest levels will therefore cause a flow of short-term funds from the gold-receiving to the gold-losing country.

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This flow of short-term capital will supply foreign balances for, and ease the deflationist strain in, the deficit country. Such an adjusting movement is extremely important for the smooth working of the gold standard mechanism. 1

But if the price levels of countries are out of line with each other, the basic and long-run adjustment is to be attained from the changes in the respective price levels which the reciprocal policies of credit contraction and credit expansion are to bring about.

The gold losing country will reduce its price-cost structure, will export more and import less, and, with opposite adjustments in the gold receiving countries, international payment equilibrium is basically restored—not simply patched up. 2

The guarantee of stable exchange rates which induced and promoted international trade and investment, while discouraging disequilibrating speculative movements of short-term capital, was the outstanding virtue of this mechanism.

The gold standard mechanism uses small and early-applied doses of inflation and deflation in hopes of avoiding deflations and inflations of the more violent and self-propelling type......Reserves of international liquidity (gold reserves) are provided as shock absorbers. 3

In the economic and political environment of the decades preceding the outbreak of the first world war, where there was a large degree

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2 Loc. cit.

3 Ibid., p. 15.
of economic internationalism, the gold standard worked rather smoothly and successfully. This large degree of economic internationalism had prevailed then because of free trade over vast areas, relatively stable tariffs tempered by the application of the "most favored nation clause", an almost complete freedom of international capital movements, the elastic world demand for exports, flexibility of the price-cost structure of the member countries, both upwards and downwards, and sensitivity of the national monetary circulations to gold flows. But it is a "fair weather craft, of doubtful seaworthiness in stormy waters."¹

In a world torn apart by hostilities, with economic controls taking the place of the peace-time freedom of economic transactions, and an interruption of all the normal commercial and financial operations, an international monetary system could not survive and had necessarily to break down. The dislocations caused by the war, the struggle throughout the world to achieve economic stability, the strengthening of the spirit of nationalism, the failure to attain effective international cooperation, and finally, the catastrophe of world wide depression combined to form a political, social, and economic environment in sharp contrast to that of the prewar period.

¹ Loc. cit.
The main reasons for the failure to rebuild this system after the war were:

1. The reconstruction was started too late and was carried out in too fragmentary a fashion;

2. The change of economic condition and other factors stood in the way of the re-adoption of the gold standard in its prewar form, while no consistent new system was envisaged;

3. The reconstruction was impeded very seriously by the prevalent fear of the scarcity of gold; and

4. The growth of economic nationalism prevented the creation of an economic environment in which monetary stability could be maintained.¹

The year 1919 and the period immediately thereafter witnessed exchange instability in many countries due to the disturbed international economic and political conditions and to the uneven progress of inflation in the various countries. In such a context, the first international financial and monetary conference that met in Brussels in 1920, and the second in Genoa in 1922, were welcome to a monetarily chaotic world. But as these plans did not create an effective machinery to handle the disrupted economies, they did not solve any problems. However, in 1929, an international institution, the Bank for International Settlements, was set up as a by-product of the reparation settlement. The Great Depression

dealt a very severe blow to this. Besides, the meagre resources at the disposal of the bank rendered it incapable of playing a significant role in forestalling the monetary disintegration of the thirties.

The impending scarcity of gold led the individual countries to adopt different variants of the gold standard. The price level of most countries was substantially higher in the middle-twenties in terms of the dollar or sterling than it had been in 1914; yet the price of gold in terms of dollar and sterling remained on the prewar level, or was brought back to it. The new gold standard was a collection of ad hoc devices. It is tragic that no international agreement was reached at any time in the twenties, because the de facto correlation of economic, financial, and monetary policies which prevailed prior to World War I made it all the more necessary for a concerted attempt to reach agreement on an instrument of international monetary cooperation.
CHAPTER II

INTERNATIONAL MONETARY LESSONS OF THE THIRTIES

The chaos and confusion of the early 1930's was followed by a period of substantial changes and experimentation. The collapse of the restored gold standard came in two stages: Its abandonment by Britain in 1931, and by the United States in 1933. The Depression which began in 1929 had very far-reaching repercussions on the economies of the world. Those countries which depended for their economic and financial stability and solidarity on an influx of foreign capital found it lacking as the creditor nations stopped their capital exports and added insult to the injury by withdrawing even short-term capital funds which initiated the wave of currency depreciations, devaluations, and exchange controls. Thus, England in 1931 was forced off the gold standard after sustaining great losses of gold. In 1925 Great Britain, along with other major trading nations, had returned to the gold-standard at the prewar parity on the basis of what Professor Robbins describes as hit-or-miss methods.\(^1\)

that totally disregarded the purchasing power parity theory. \(^1\) This parity put England's export industries at an artificial disadvantage at a time when her export trade was in a most difficult position, owing to the disruption of her foreign markets and other structural changes as a result of the war.

The attempt towards deflation failed, and it was realized that

\[ \ldots \text{pressure can be brought to bear on the users of credit by a restriction of credit or the raising of bank rate, but that pressure cannot be directly brought to bear upon the costs of production.} \]

Wage costs in particular were rigid, at least in a downward direction. The resultant export difficulties restricted the long-term capital exports, while the constant gold outflow and high interest rates attracted short-term funds, bringing about in the words of Robbins "a lack of balance between long-term and short-term investment which was itself conducive to dis-equilibrium and latent with danger of extensive catastrophe."\(^3\)

This embarrassing financial predicament of England brought about her divorce from the gold standard and also the devaluation of the pound in September, 1931, which in turn brought about modest recovery.

\(^{1}\) The Theory says that the exchange rates should be in conformity with the domestic price levels.


\(^{3}\) Lionel Robbins, op. cit., p. 9.
The countries of the British Commonwealth of Nations, the Scandinavian countries, and others found the stability of their currencies in terms of sterling rather than gold and therefore followed suit, which brought into being the sterling bloc. The world split into the sterling area, the gold area, and the heterogeneous group of countries practicing various types of exchange controls. Each experienced a degree of depreciation. The Soviet Union with its satellites formed the other area. In 1933, devaluation of the dollar dealt a death blow to the gold standard.

Reckless lending and borrowing, coupled with inconsistent policies, characterized the thirties. "That the main creditor countries tried to exclude the commodities of the debtor countries through protectionist devices is one of the most glaring inconsistencies of the interwar period."

The creditor countries, by neither purchasing additional imports nor using their receipts to make long-term loans, either of which they were duty-bound to do, forced the debtor countries into deflation, devaluation, and exchange controls.

After devaluation, England established in April, 1932, the British Exchange Equalization Account to offset speculative movements in sterling exchange rates. Similar exchange stabilization funds, which tried to counteract abnormal changes in demand on the foreign exchange markets by managing the supply, were established in other countries. A typical

exchange stabilization fund consists of foreign balances or gold and of domestic money, and it serves as a buffer which mitigates the impact of repercussions resulting from policies of different countries. The connection between the foreign exchange markets and domestic money markets is made subject to a controlling device which replaces the golden brake of the credit machine by the gear shift of the stabilization fund. According to Halm, these funds "as a pool for concerted action, point to the very core of the new plans for international monetary cooperation."

The Tripartite Agreement of 1936, between the United States, the United Kingdom, and France, and also joined by Switzerland, Belgium, Holland, and indirectly by the whole "sterling bloc", eliminated competitive depreciation of currencies and resulted in a certain amount of collaboration between the stabilization funds of several countries.
CHAPTER III

THE PROBLEMS OF MONETARY STABILIZATION

Having followed the history of the gold standard through its heyday to its collapse, we may make a detour into the problem of monetary stabilization before grappling with the different plans that were conceived to achieve that objective. Monetary stability broadly understood is synonymous with stability of the general price level. In its narrow sense, it means the fixing of the value of a particularly wayward currency in terms of some less erratic money or merely the elimination of extreme shifts in its purchasing power.

The value of any given currency may be measured either by its command over commodities in the area in which it circulates or by the rate at which it exchanges against other currencies. The rate at which one currency exchanges for another depends, however, upon the purchasing power of the measuring as well as of the measured money. Stable purchasing power of any given monetary unit is possible with unstable exchange rates. Also, the exchange rates may be kept stable although the commodity purchasing power of the currencies concerned is fluctuating; all that is necessary is that the currencies should fluctuate substantially in unison.
Thus, with exchange rates accurately reflecting the internal purchasing power of the currencies concerned, Frank Graham points to four possible sets of relationships in respect to stability of any given currency. These are:

1. Stable internal purchasing power and stable exchange rates—all currencies are stabilized; 2. Stable internal purchasing power and unstable exchange rates—the measuring currencies are unstable; 3. Unstable internal purchasing power and stable exchange rates—the measuring currencies are unstable, but fluctuations occur in unison with those of the measured currency; and 4. Unstable internal purchasing power and unstable exchange rates.

The measuring currencies may be either stable or unstable and exchange rates will therefore tend to fluctuate in the one case proportionately and in the other disproportionaly with the changes in the internal purchasing power of the measured unit.  

There has, however, been no currency with unvarying purchasing power. The third possibility has been realized whenever a given monetary material has become widely established. The problem of monetary stability in the narrower sense arises with respect to one or more currencies of the type indicated in the fourth category. This problem led to the resumption of the gold standard as a means of securing some degree of stability in the purchasing power, with absolute stability in exchange rates of gold-standard countries.

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In inconvertible paper monetary systems, a thorough-going currency disintegration may happen. The first paper pound from 1797-1821 was an exception to this. There are physical limits to the possibility of currency expansion under metallic monetary systems, whereas under inconvertible paper self-restraint is the only limit. This is an inadequate safeguard.

After World War I the extreme monetary disorganization that became the order of the day on the European continent rendered currency stabilization an urgent necessity for many countries. And out of the varied experiences of these countries, something like a standard body of doctrine has emerged.

Frank Graham observes that three principal types of wartime inflation and depreciation may be distinguished. In Great Britain, Holland, Switzerland, and Scandinavian countries inflation and depreciation were not so great as to make impracticable the restoration of the prewar monetary unit. The restoration and maintenance of a full or modified gold standard involves the equation of inflated paper with world gold price levels. This may be achieved either by such an alteration of the paper price structure as will bring it into correspondence with gold prices at a predetermined gold value of the currency unit, or by such an alteration of the original gold weight of the currency unit as will sustain the current price level on a gold basis. Stabilization of a depreciated currency at the
original gold value of the monetary unit is possible only through a process of deflation and a postponement of final action until prices can be reduced to a requisite level.

Where depreciation has been so great as to make the continuance of the old value of the currency unit impracticable, because it would involve an interest burden on the public debt (approximating or exceeding the prospective national income), devaluation becomes clearly inevitable. The restoration of the original value of the depreciated currency means a prolongation of instability. It also brings about that most devastating form of price change, that is to say, a prolonged fall with an accompanying strain on business and financial institutions and widespread unemployment.

On the combined grounds of equity and expediency, the choice of the stable rate of exchange should be somewhat, but not greatly, below the existing value of the currency unit. There are two measures of this value, the price level and the exchange rate. Usually, the lower of the two prices is taken with the exception that if the exchange value of the currency is extremely depressed relatively to its value as indicated by the price level, it may be worthwhile to attempt stabilization at a higher figure than the existing exchange rate would seem to warrant.

The irresponsible issue of paper currency, with its evil consequences of advance in internal price level, rising cost of gold exchange,
and unbalanced production, etc., can be annulled by a large reserve of gold or foreign exchange acquired in advance through a foreign loan or otherwise, which will cushion any excess of current demand over supply for exchange at the chosen rate. To John Maynard Keynes, the problem of monetary stabilization resolves into three parts:

1. Devaluation vs. deflation.
3. Restoration of a gold standard.

Deflation, which is a policy of reducing the ratio between the volume of a country's currency and its requirements of purchasing power in the form of money so as to increase the value of the currency in terms of gold or commodities, is undesirable as it redistributes wealth in a manner injurious to business and to social stability. It brings about a transference of wealth from the rest of the community to the rentier class and to all holders of titles to money just as inflation involves the opposite.

Speaking about the stability of prices vs. stability of exchange, Keynes favors the stability of internal price levels. The fault of the post-war regime is that price levels depend on internal influences and the rates of exchange have to adjust thereto. Thus, when there are violent shocks to the pre-existing equilibrium between the internal and external
price levels, the prewar method is likely to break down in practice only because it cannot bring about readjustment of internal price levels quick enough.

The Keynesian conclusion is that

... when stability of the internal price level and stability of the external exchanges are incompatible, the former is generally preferable. If all other countries restore the gold standard, the restoration of it would give us not the stability of internal price level, but external exchanges. The conditions of the future are not those of the past. The restoration of the gold standard in the present conditions is just not possible. We are now interested in the stability of business, prices, and employment.¹

This chapter, it is hoped, will serve to help understand the problems with which the IMF has had to wrestle and around which its activities center.

PART II

PLANS FOR INTERNATIONAL MONETARY COOPERATION
CHAPTER IV

THE ROAD TO BRETTON WOODS

Many expert and keen brains were heavily exercised on the problem of monetary instability, and two plans for stabilization were suggested: one by Harry D. White, the able monetary adviser to the United States Treasury, and another by Lord Keynes of England. The two plans form the keystone of the arch of international monetary cooperation of the post-war world. The subject matter of this chapter therefore is a comparison in broad outlines of these two plans, out of which emerged the International Monetary Fund.

The field in which the world, after World War II, needed urgently remaking through rethinking, was the field of International Economic Relations. In that field, the pattern of international monetary institutions is of cardinal significance. Monetary stability hinges, as we saw in the preceding chapter, on the problem of fluctuating exchange rates vs. fixed exchange rates. Recognizing this as of universal concern and also seeing the need to keep the foreign balances arising out of normal trade transactions as liquid and unfrozen as domestic bank balances, the two draft
plans of Lord Keynes and White were circulated widely with official support. "Cast in an essay form the Keynes draft is a masterpiece of persuasive exposition," while the American plan is in the form of a draft bill.

Broadly speaking, the International Stabilization Fund of White and the International Clearing Union of Keynes have in common the four following objectives:

1. Control by an international agency over the levels of exchange rates of national currencies;

2. Provision by this agency of an effective system of multilateral clearings;

3. Regulatory or admonitory power of this agency with respect to monetary and other procedures followed by particular countries which are such as to disturb or threaten international economic equilibrium;

4. Augmentation of and a better distribution of the world's supply of liquid means of international payment.

The most significant differences between the plans are in the extent of the grant of power and financial means and in the types of procedures for promoting these objectives which they propose. As the names suggest, exchange stabilization in White's Plan and clearing function in

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2 *Loc. cit.*
Keynes' Plan receive emphasis. Both plans give the governing board powers to call for relevant information from the participating governments, and to make the recommendations and impose penalties for excess debit balances, though Keynes has a novel feature of imposing penalties on even the excess creditor balances. Criticisms from an international agency of such repute and good standing, however, might prove to be more effective than financial penalties or rewards in inducing members to avoid practices that are inimical to the maintenance of international monetary equilibrium. Both envisage this agency to have as its primary operating function the banking function proper, that is, the transfer of monetary assets on a loan basis from those who are in liquid position to those who are in need of funds.

Though White requires the members to make an initial capital contribution in local currency, gold and government securities, Keynes does not make any provision for this because what he contemplates is a mutual credit pool. Under both plans

....the purpose of such banking operations would be to provide suitable credit facilities for countries temporarily short of means of meeting external liabilities on current account so as to make it possible for them to make the necessary payments without pressure on the exchange values of their currencies and without resort to deflationary internal measures, to restrictions on imports or to the application of exchange control to commercial transactions.¹

¹ Ibid., pp. 85-86.
If the world is to move as envisaged by White and Keynes to an international currency divorced from gold, and constituting the sole monetary unit generally usable in making international payments, the Keynes plan will have gone farther in the direction of setting up formal relationships appropriate to the new currency and abolishing formalities of existing procedure in international monetary transactions. The real contribution of these plans is not the machinery provided by them to offset debits and credits. It is the technique of promoting exchange stability and the expectations of its indefinite continuance that they created by way of requiring the countries to abandon bilateral clearings.

There are a great many other details in both plans about the ways in which international monetary equilibrium has to be attained. From the point of view of world economy, two questions are of paramount importance, concerning which there exist wide differences of opinion between monetary nationalists and internationalists. These questions are the following:

1. Stable parities vs. fluctuating exchange rates or flexible parities; and

2. Free foreign exchange markets vs. exchange control.

The White plan seems to look towards absolutely fixed exchange rates as the normal situation, while the Keynes plan, on the other hand, seems to look towards internationally regulated flexibility of exchange rates. But
in the absence of log-rolling, majority consent as prescribed by Keynes to the depreciation of a major currency would scarcely ever be obtainable from an international body and therefore the Keynes plan, except for its sanction of an initial depreciation of five per cent, would in practice impose as much rigidity of exchange rates as would the apparently less elastic White plan. On the second question, both admitted a certain amount of exchange control, especially with respect to capital transfers.

By creating an additional and flexible supply of internationally liquid means of payments, both plans would provide needed safeguards against either world or local deflations originating in national balance of payment difficulties. In doing so, however, both plans would furnish additional tinder for world-wide inflation.¹

A broad comparison of these two plans will give us an insight into the present day international monetary institution and it is this same apprehension of inducing a possible inflation by these plans that the Fund faces today.

While a great many financial wizards and economists rallied to these plans, Prof. J. H. Williams of Harvard University deprecated the tendency at over-all organization, and suggested what is known as the "Key countries approach" to the problem of monetary reconstruction.²

¹ Ibid., p. 101.

² John H. Williams, "Currency Stabilization; the Keynes and White Plans," Foreign Affairs, July 1943. "Currency Stabilization; American and British Attitudes!", Foreign Affairs, January 1944.
He pointed out the need for basic dollar-sterling stabilization and urged a gradual and progressive development from that point on.

The public and official debates on these plans paved the way to Bretton Woods. On April 21, 1944, a Joint Statement by experts on the Establishment of an IMF was published. Subsequently, the United Nations at Bretton Woods, with the Joint Statement as ground work, agreed to set up an International Monetary Fund, and also the International Bank for Reconstruction and Development.

By maintaining the form of White's plan, it also incorporated the sounder elements of greater flexibility in monetary parities, a greater emphasis on the responsibilities of those countries with chronic surplus in their balance of payments, and a greater exchange control during the transition period following the war. The plan for IMF, as it finally emerged, is therefore closer to White's plan than Keynes'.

A word about IBRD. The shattered economy of the post-war world needed capital on a large scale for economic development for underdeveloped economies of Asia and Africa and for rehabilitation of Europe. The IBRD function of lending or investing capital on a long-term basis for purposes of economic development is therefore different from that of the IMF, which transfers funds to correct the temporary maladjustments and short-lived disequilibria. A narrow interpretation of this term "temporary maladjustment" has been responsible, as we
shall see later, for the inadequate activity of the Fund. Not until 1952 did the Fund, facing a volley of criticisms from members, liberalize its lending policies by introducing the novel stand-by credit arrangements.
CHAPTER V

A SYNTHESIS: THE INTERNATIONAL MONETARY FUND

The preceding historical analysis of the monetary developments and the twenty years of monetary troubles between the two wars suggest the need for an international monetary system that would provide for unrestricted world trade. The rest of this thesis will cover what the Fund was intended to accomplish, and review its operations since its inception.

Purpose:

Article I of the IMF enumerates the main purposes of the Fund. They are:

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

2. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real
income and to the development of the productive resources of all members as primary objectives of economic policy.

3. To promote exchange stability, to maintain orderly exchange arrangements among members and to avoid competitive exchange depreciation.

4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

5. To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing members with opportunity to correct maladjustments in members' balance of payments without resorting to measures destructive of national or international prosperity.

6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of the members.

As all the decisions of the Fund are to be guided by Article I (above quoted), we may see how the Fund has tackled the several crises it encountered so far.

Objectives one and two call for a well-ordered monetary set-up to facilitate trade and contribute to the growth of prosperity. The third
purpose is the most important aim of the Fund as indeed of any form of international monetary organization. Point four supplements this by emphasizing the need for creating a truly international system of payments and abandoning the various types of restrictions which grew up during the thirties. Point five is an elaboration on the subject of point three. The element of confidence is very important. Crises of confidence lead to panicky flights of capital, as they did in 1949 in England, and thus either to currency breakdowns or to highly restrictive measures of control. An adequate access to liquid means of payment is one of the best safeguards against panic. It should however be noted here that access to its liquid resources is provided in order to facilitate the adoption of corrective measures to cure the ills and not as a permanent solution.

Organization and Structure:

The membership of the IMF, at present 66,\(^1\) embraces practically all of the countries of the world except those of the communist bloc. As of April 30, 1958, U.S. $9,088 million in gold and national currencies had been paid to the Fund by its members to provide resources to be used to carry out its objectives. The payments have ranged from $2,750 million by the United States to $500,000 by Panama.

\(^1\) With the merger of Egypt and Syria into a single state, the United Arab Republic became a single member of the Fund with a single quota.
All the powers of the Fund are vested in a Board of Governors consisting of one governor and one alternate appointed by each member country. Many countries have named their Ministers of Finance or the Governors of their Central Banks to the Board of Governors. The Board of Governors meets annually and this meeting constitutes an occasion not only for conducting the business of the Fund, but also for informal discussions among members on other matters.

The Board of Governors has delegated its powers to the Executive Directors, except in relation to certain matters reserved to the Board of Governors under the Articles of Agreement. The Executive Board consists at present of 17 Executive Directors. Each of the five countries with the largest quotas (United States, United Kingdom, China, France, and India) appoints one Executive Director. The other Executive Directors of the Fund are elected by members for a two-year term, each Director representing a member country, or group of countries. Each Executive Director appoints an Alternate from his own country, or from one of the other countries that he represents. Thus, the membership of the Executive Board assures an adequate voice to all regions and strengthens the predominant tendency to give full weight to international considerations.

The Executive Board has power to give approval in all matters requiring Fund consent, except for the powers reserved to the Board of
Governors. Thus, it may concur with or object to changes proposed by members in the par values of their currencies. It may approve the imposition by members of restrictions on payments and transfers for current international transactions, discriminatory currency arrangements on multiple currency practices, which are not otherwise authorized under the Fund Agreement. The transactions by which the resources of the Fund are made available to its members are under the jurisdiction of the Executive Board. The Board functions in continuous session, so that the business of the Fund can be carried on without interruption. The views of the Fund are conveyed to members or other international agencies after discussion and approved by the Executive Board headed by the Managing Director, who directs the day-to-day work also.
PART III

PROGRESS OF THE FUND
CHAPTER VI

THE EARLY YEARS OF CRISIS

Though "established in haste", as R. G. Hawtrey says,¹ the IMF in its early years had to wrestle with tremendous burdens and ravages caused by war. In 1946, in Savannah, the Board of Governors had to decide the basic character of this institution—whether it was to be political or technical. The danger of political intrusion is present with the Fund whose concern is primarily with monetary policy, a jealously guarded preserve of national sovereignty. They decided that the object of economic stability and peace could be achieved by making the Fund a technical institution which would never question domestic policies.

The system embodied in the Bretton Woods agreement of 1944 seeks to achieve international economic and financial equilibrium by internal price and income adjustment (as under the gold standard) cushioned somewhat by the judicious use of international credit. In addition, provision is made for adjustment of exchange ratios in cases of "fundamental disequilibrium." The key characteristic of any system of

international payments is the relative weight that it gives to adjustment and credit.

The years of depression and the immense influence of Keynes made Britain determined to avoid the restoration of a straight jacket of the gold-standard type that would expose the domestic economy to the contamination of a world slump. On their side, the American negotiators cited the years of competitive devaluation and exchange control that followed the break-up of the gold standard as a warning of the danger of abandoning all external discipline. The agreement affirmed the principle of exchange stability, but it also made specific provision for periodic exchange adjustments to correct a "fundamental disequilibrium."

In the following pages an attempt is made to see how successful the Fund has been in reconciling independent domestic policies and stable exchange rates. To what extent it has promoted exchange stability by mitigating the balance of payments difficulties of the different nations, and the degree to which various restrictive devices have been reduced or eliminated will also be considered.

**International Economic Situation:**

The appropriate starting point for a more detailed examination of its progress since its establishment may be a brief review of the international economic situation in the beginning years of the Fund.
By the end of 1947, Europe's working population and productive capital were up to the prewar level, although differently distributed as between countries and as between economic activities. Europe's external position on the other hand was much less favorable than before the war. The recovery in trade took much longer than that in production and, indeed, trading difficulties formed one of the major obstacles to the smooth development of the European economies. The severing of Europe from its normal overseas suppliers greatly stimulated the development of industries producing replacements for imports, the result of which was to put Europe in a better position to cope with its external difficulties in the post-war period.

The relatively favorable position in industry generally is confirmed by the speed with which industrial production attained or exceeded the prewar level in spite of the difficulties created by shortage and lack of balance in working capital, and the shortage of managerial ability and confused situation as to ownership of property which were in some countries the legacy of the war and its aftermath. In spite of the low level from which some countries started in 1945, the majority had recovered in the narrow sense within two years of the ending of the European War. But the recovery of Germany, either in the west or in the east, did not begin until 1948. ¹

The aim of European countries, however, was not only to restore prewar levels of production, but to continue to increase output further and to increase it at a faster rate than in the interwar period. All governments in Europe, in the east through central economic planning, in the west through nationalization of the basic industries or through greater control of the public economy, aimed at increasing industrial and agricultural output. This was thought necessary to restore external balance, to achieve higher standards of living or simply to keep in step with other countries. The result was a heavy demand for investment goods. Unless held back by restrictive policies, these demands were bound to call for further and substantial rises in output.

A properly functioning peacetime economy in Europe could be restored only by re-establishing the trading relationships both within Europe and with the outside world on which the necessary flow of imports depended. But since the war there were some radical and irreversible structural changes in Europe, like the division of Europe into East and West. Eastern Europe by its concentration of the foreign trade in state monopolies had more direct means of enforcing a balance in the foreign transactions. For Eastern Europe a balance of payments problem like the "dollar problem" of Western Europe could scarcely exist. This made it difficult to reconstruct a free and multilateral pattern of world trade and payments. However, inflationary conditions in European countries
as elsewhere in the early post-war period undoubtedly influenced adversely
the level of their imports and exports and tended to distort the pattern of
their external trade as well as their domestic production and investment.

So despite all the physical upheaval of the Second World War, the
task of reviving production and trade after the war proved to be infinitely
easier than that of restoring a viable international balance. In Southeast
Asia the recovery period was rather prolonged, partly because of the rela-
tively slow revival of agriculture and partly because of the great complex
of problems which accompanied the transition to independence in many of
the countries in the area. The Bretton Woods institutions, despite the
careful forethought that went into them, did not recognize the full signifi-
cance or the scope of the problem of international imbalance. 1

Thus, the pattern of international trade and payments emerging in
the course of the early post-war years represented a response to tremen-
dous shifts in the world distribution of income, productive capacity, and
exchange assets resulting directly or indirectly from the war.

More than a year after the establishment of the Fund,
the world is confronted with seriously unbalanced trade,
with an urgent problem of financing international payments,
and with severe shortages of goods for reconstruction and
even for maintaining minimum consumption standards in
many countries. 2

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Recognizing the magnitude of the task before them, the Executive Directors of the Fund in their first Annual Report, instead of stressing its importance, go on to comment that

\[\ldots\text{the Fund cannot solve these problems, but the role which the Fund will be able to play in the future must inevitably be determined in large measure by the way in which these problems are solved.}^{1}\]

Large parts of the world were still in turmoil. Consumption was held considerably below the prewar level. There was a lack of productive resources for many urgent tasks and a scarcity of labor in Europe. Added to this was the loss of Germany as a source of supply. Before the war, 70 per cent of Germany's exports consisting of coal and fertilizers, machinery and equipment (so essential for reconstruction), went to Europe. As a result, the task of reconstruction became very difficult. Nor was the international political environment conducive to economic stability and progress.

Although the total volume of world exports in 1946 was only about 15 per cent below the 1938 level, the pattern of world trade was radically changed. Before the war, the countries of Europe and the Far East accounted for the larger part of world trade and service transactions. Before the war, Germany and Japan, who together accounted for 13.5 per cent of the world's exports, supplied in 1946 only one per cent of the

\[\text{\textsuperscript{1} Ibid., pp. 2-3.}\]
The European countries engaged in the war, excluding the United Kingdom and Germany, accounted for 23 per cent of the total of world exports before the war. In 1946 these same countries accounted for only 11 per cent of world exports. The exports of these countries as a group were about 60 per cent below the 1938 volume.

The United Kingdom had a problem in international payments in many respects unique. The large decline in her overseas income from service items and the big increase in government payments overseas had reduced sharply her ability to pay for imports. Although exports from the United Kingdom in 1946 were approximately the 1938 volume, the level of imports was 31 per cent below prewar.

The decline in exports was more significant in the case of the countries of the Far East, it being 30 per cent below the prewar volume. The relieving feature of all this is that the United States and Canada, who were not directly affected by devastation, increased their exports by 90 and 45 per cent, respectively, above the prewar volume. The imports of both were 40 per cent larger than before the war. The volume of world trade in 1947 was above the prewar level, though the pattern of trade radically differed.

These changes in the volume of trade with the relative rise in prices of goods and services influenced significantly the international payments position in 1946. The edifice of international payments has
been affected by the loss of foreign investments, which for countries like the United Kingdom, France, and the Netherlands was a great source of earnings. The rise of the foreign expenditures of some governments like the United Kingdom and the United States is a new factor in international payments. In the case of the United Kingdom, the necessity of continuing large government expenditures abroad accounted for three-fourths of the 1946 balance of payments deficit of $1,600 million.\footnote{All these figures with those in the rest of the thesis are taken from the statistical documents of the International Monetary Fund and also from the Statistical Office of the United Nations.}

This distortion in international payments by causing a serious balance of payments problem had rendered the task of restoring convertibility more difficult. Despite the grants, credits, and foreign aid provided for reconstruction, the availability of foreign exchange receipts and monetary reserves affected the share of imports going to different parts of the world.

Assistance from the Fund:

This unbalance in world trade reflected the capacity of the Western Hemisphere to produce and export and the urgent need of Europe and the Far East for imports for reconstruction. The considered opinion of the Board of Executive Directors of the Fund was that it was a mistake to force an early shift in the direction of world trade. The problem was
rather to finance the flow of goods to those areas to enable them to restore production and exports and gradually to shift the direction of trade to the pattern suitable to the period after transition.¹

This was done, as is evident from the grants by governments through UNRRA of about $7.7 billion from the end of the war to the middle of 1947. In the same period, aggregate credits amounted to approximately $13 billion—the United States being a major contributor in both cases. The monetary reserves of the rest of the world were insufficient to meet a sustained balance of payments deficit with the United States. (In the first half of 1947, these countries used $2.3 billion of gold and short-term dollar assets to finance imports from the United States.) In the circumstances it was through self-help and increasing their production that the countries of Europe and Far East could in time provide the exports to balance their international payments. A high level of trade also had to be maintained.

Viewed in this perspective, the recommendation of the Fund to its members to check inflation, was timely. It also urged them to restore and maintain confidence in their currencies. As the resources of the Fund and IBRD are limited and as the former is not intended to give help in reconstruction, the best it could do was to provide temporary exchange

¹ International Monetary Fund, op. cit., p. 10.
assistance to its members during the transition period. The advice and assistance of the Fund in its first year of operation was a considerable help to these countries.

As of June 30, 1947, the total amount of subscriptions paid was the equivalent of $6,535 million, of which $1,344 million was paid in gold and the equivalent of $5,190 million was paid by members in their own currencies and the remaining $1 million was paid in United States dollars by all members to defray administrative costs.

**Initial Par Values and Exchange Stability:**

The determination of a satisfactory pattern of exchange rates is a difficult problem at any time and more so in a disorganized and devastated world economy. However, this was a major task of the Fund in its first year. The establishment of initial par values by the Fund on December 18, 1946 set at rest the fears of many members of competitive (exchange) devaluation. Hence, the Fund Agreement lays down

.....that par values of the currencies of the members are to be established in the first instance by agreement with the Fund. Thereafter, they may be changed only after consultation with the Fund and in accordance with the Fund Agreement. ¹

Along with the added strength of the national economies and the growth of world trade, this step forward of the Fund might help fulfill to a considerable extent the objectives of this institution.

As of June 30, 1947, the Fund accepted parities proposed for 36 currencies. "No criticisms or second thoughts suggest themselves regarding the original decision to accept the parities notified by members before the Fund started to operate."¹ But the inflationary fiscal and credit policies adopted by the members threatened to impair and undermine the parities of the currencies of these countries. In this context, by calling the attention of these members to the need for tackling this problem effectively, the Fund did a brave and timely act.

The Fund also requested the members to cooperate with it by eliminating external gold transactions at premium prices which generally involve a loss of gold from monetary reserves and which would make futile the attempts to establish exchange stability.

**Exchange Restrictions and Multiple Currency Practices:**

The Fund's record is .... vulnerable on the issue of multiple currency practices with differential rates of exchange, ......... Multiple currency practices not only call into question the official parities recognized by the Fund; they are also leading to an increasing distortion of the channels of world trade, a distortion which mainly harms the countries which continue to shun these practices.²


² *Loc. cit.*
However, in a period of transition, a lack of doctrinaire approach is quite understandable. Determined to tide over this period smoothly, the Fund had to resort to certain transitional arrangements, though in the ultimate analysis it wanted to see a world free of exchange restrictions of any kind. As we saw earlier, the pent-up demand of war-time, along with the heavy demand for imports for reconstruction and development purposes in all the countries of the world, necessitated a resort to certain exchange restrictions, which was preferable to exchange depreciation. This forced the Fund to recognize the multiple currency practices of certain countries like Ecuador.

Those which are designed to restrict imports can be removed only when exchange rates and domestic price levels are adjusted to balance exchange receipts and the cost of necessary imports.  

Nevertheless, the Fund since it started operating has been ceaselessly fighting to remove exchange restrictions. The most significant development in the elimination of war-time exchange restrictions was the re-establishment of the transferability of sterling in current international transactions. The Government of the United Kingdom agreed to complete arrangements under which the sterling receipts from current transactions of all sterling area countries would be freely available for

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1 International Monetary Fund, op. cit., p. 35.
current transactions in any area without discrimination. The wider use of sterling which this development made possible meant in practice that a very large part of the trade of the world was conducted in terms of transferable currencies, particularly the United States dollar and sterling. Expressing satisfaction, the Report says

The objective of restoring a system of multilateral payments, under which the proceeds of exports to any country can be used to pay for imports from any other country, is thus nearer achievement. ¹

No less important was the development of the proposed International Trade Organization to provide safeguards against direct trade controls. The charter of ITO provides for close consultation between the Fund and itself on all balance of payments and monetary reserve problems. Repeatedly the Report says that the restrictionist policies adopted during the transition period are to be ended following the termination of this period. The Fund also has provided machinery for coordination and cooperation among nations which is indispensable for progress.

To expatiate at such length on the details of operations during the first year has been found necessary because of the magnitude of the task involved and the headway made by the Fund through this chaotic situation it encountered. Hereafter, however, the particular issues that the Fund solved or has been instrumental in solving will be discussed.

¹ Ibid., p. 37.
One of the basic purposes of the Fund is "to promote exchange stability." But this implies that when adjustments in exchange rates are necessary they should be made though made in an orderly manner. Thus, the Report of the Fund for the year 1948 draws a contrast between stability and rigidity. On the question of the validity of the exchange rates, the Fund reiterated the now familiar point of view that so long as an exchange rate did not hamper a country's exports there was little to be said in disturbed world conditions for altering it. The Report adds, however, "that in some countries the exchange rate is becoming a restraining factor on exports and that it is adding to the difficulty of earning convertible currencies."\(^1\) However, an exchange rate adjustment undertaken by a country suffering from inflation might temporarily correct a price relationship which had begun to hamper exports. But without effective anti-inflationary measures, the benefits of the adjustment would soon evaporate. Although the Fund is not entitled to propose a change in the par value of a currency, it has an obligation to keep the exchange rate situation under review.

The Fund noted with satisfaction the inauguration in April 1948 of the European Recovery Program, which assured the continuance of the United States in the reconstruction and recovery of European economies.

Though 1947 was a year of progress from the point of view of production, the international payments position continued to worsen, as most countries sought to augment their productive resources by enlarged imports to speed recovery. As the pressure on reserves increased, a number of members found it necessary to draw upon the Fund. Aggregate exchange sales by the Fund for local currency amounted to over $460 million in 1947. While this sum is not large, compared with the dollar deficits of the countries concerned, the aid from the Fund came at a time when other resources were sharply diminished and gold and dollar reserves were falling rapidly.

Unlike the years before the establishment of the Fund, when deflation was a common experience, the years after the war witnessed the generation of both latent and actual inflation. As inflation is a serious handicap to recovery and the restoration of international economic equilibrium, the Fund exerted its influence with its members to fight this dreaded economic malaise. The governments of the member countries with the understanding and cooperation of their public had to fight this. The Fund could only impress on them the necessity to undertake measures to fight it. The prime responsibility, therefore, lies with the members themselves.

On the subject of exchange restrictions, multiple currency practices, and convertibility of currencies, the Reports of the Fund for 1948
and 1949 were not encouraging. As regards the first, it noted that so long as the existing economic conditions continued, the member countries could not be expected to remove the exchange barriers and also so long as the world trade pattern remained as distorted and unbalanced as it was then, convertibility was difficult of attainment. The continuance of such practices, of course, runs counter to the objectives of the Fund. The work of the Fund, it must be recognized, is carried on by the Executive Directors who represent the national interests of these countries and are not yet prepared to sacrifice their short-term interests for the benefit of the entire world. This inherent contradiction of working for a world economy by people who are still largely motivated by national interests, has stultified efforts of the Fund on these questions. Hence, it continues to emphasize the virtues of maintaining orderly cross rates, avoidance of fluctuating rates, free convertibility, etc.

Convertibility:

During this period, however, limited progress was made. Thus, in 1947, a major attempt was undertaken to render convertible all sterling accruing from current transactions. By the terms of the Anglo-American Financial Agreement of 1945, the government of the United Kingdom agreed that after July 15, 1947, it would impose no restrictions upon payments and transfers for current transactions and would permit the current sterling receipts of sterling area countries to be used in any
currency area without discrimination. By July 15, 1947, therefore, through a series of actions it brought about the convertibility of sterling throughout the greater part of the trading world. This, or course, did not obligate the United Kingdom to remove all trade and exchange controls. However, the drain on exchange resources, which for that year alone accounted for 85 per cent of the net use of reserves and dollar credits, forced the United Kingdom to withdraw the facility of freely transferring sterling from Transferable Accounts to American or Canadian Accounts, while at the same time eliminating Canadian Transferable Accounts. Even though convertibility of sterling into dollars was suspended, sterling remained transferable over a wide area. The British government did not lose any opportunity to announce that this was only a temporary emergency measure and that convertibility was its long-run objective. All this shows that free convertibility cannot be maintained unless a system of multilateral trade and payments is established and unless the great trading countries, whose currencies are used in international payments, have restored a reasonably satisfactory balance in their current international accounts.

The Fund also noted the efforts in the latter part of 1947 of the Committee on European Economic Cooperation to develop machinery for clearing European accounts.
If European payments were placed on a multilateral basis each country could import from other European countries goods which are most essential to its economy; in this way, the necessary shift of European resources toward production and trade compatible with over-all balance in European payments and the general convertibility of European currencies would be promoted. The Fund has also indicated that it would not object to the use of its European currency resources in moderate amounts by ERP members eligible to draw on the Fund to assist in the multilateralization of European payments provided the conditions and purposes of the Fund Agreement relating to the use of its resources are met.

The Fund also informed those members who were the recipients of Marshall Aid dollars that they could not draw on the Fund for dollars. The trend of stricter bilateral balancing of transactions in Europe was also halted by an Agreement for Intra-European Payments and compensations signed on October 16, 1948, by the OEEC countries, with the help of American funds during the period July 1, 1948 - June 30, 1949. This Agreement enabled the participating countries to cover their prospective deficits with each other during that period by an equivalent in European currencies of $810.4 million.

**France Ignores the Fund's Decision:**

France dealt a serious blow to the Fund in 1948 when by not accepting the modifications suggested by the Fund to its proposals to

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1 Ibid., p. 34-35.
change the par value of franc put into operation its exchange adjustment on January 26, 1948. The reason of the Fund for not authorizing this devaluation of the franc is logical and justifiable. For, the proposed devaluation was linked with the institution of a premium market for the dollar and certain other currencies readily saleable for dollars. This involved the introduction of a multiple currency practice and discriminatory currency arrangement which would encourage the dollar exports of other countries for re-export through France as a consequence of the disorderly cross-rates and hamper the restoration of international payments based on multilateral trade. This unauthorized devaluation of 44.4 per cent from 119.107 francs to the dollar to 214.392 francs to the dollar had rendered France ineligible to use the Fund's resources. However, the Fund welcomed later the appropriate step in the direction of an agreed par value for the French franc. By these arrangements in October, 1948, the French government eliminated, except for a few special cases, the differential exchange rates which had prevailed since January, 1948, and which had been one of the main objections of the Fund to the systems proposed at that time by the French government. Writing in 1949, the Executive Directors in their Annual Report say that the international payments problem manifests itself in several forms like some countries having large deficits financed through extraordinary assistance and others with an uncertain balance maintained at a relatively low level.
of exports and imports. Still others, with a great export capacity have
difficulty in making dollar payments, partly because of their excessive
import demand, partly because some of their exports are not paid for
in convertible currencies.  

The pressing and urgent problem for most countries of the world
outside the Soviet Bloc in 1947, 1948, and 1949 was dollar payments.
Although this problem has not been solved and continues even now, the
Fund in the period under review (1946-1949) was much exercised on this
issue. In 1947 the United States surplus which required financing (by
use of U.S. Government grants and credits, aid from UNRRA, financing
by the Fund, and the World Bank, and drawings on reserves) was $11.3
billion; in 1948 it was still about $6.7 billion. The surplus with Europe
was $6.1 billion in 1947, and $3.4 billion in 1948; with the Middle East
and Far East together, the surplus was $1.2 billion in 1947 and $800
million in 1948. To the large post-war deficits, sustained by the rest
of the world on trade account with Western Hemisphere countries, have
been added considerable deficits on nontrade account, particularly with
the United States. The Fund suggested at that time that

whatever the cause of the deterioration in
balances of payments, trade adjustments must be
the principal means of restoration for nearly all
deficit countries.  

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1 International Monetary Fund, Annual Report, 1949 (Washington,

2 Ibid., p. 10.
Also,

...it is in the general interest that international payments should be restored by the expansion of exports on the basis of relative prices and costs rather than by the contraction of imports through restrictions and discriminations. 1

Here, the Fund emphasized the responsibilities of both the deficit and the surplus countries in meeting this situation. The deficit countries must reduce their export prices to a competitive level in order to meet as much as possible of their payments problem through the expansion of trade on a multilateral basis. The surplus countries on their part must maintain high levels of national income, reduce the barriers to trade and facilitate the flow of international capital.

Changes in exchange rates under appropriate conditions should be an instrument of economic policy. But any gains from such action by the deficit countries should not be dissipated by inflation. The Fund advised devaluation in cases where discrepancy between dollar and non-dollar prices was too great to be remedied merely by appropriate contraction of costs and prices in the deficit countries and within the context of the existing exchange parities. It also pointed out that, while the United States wholesale price index for manufactures was about 175 in May, 1949 (1937 - 100) the index of export prices in dollars of the principal Western European countries exporting manufactured goods ranged

1 Ibid., p. 12.
around 210. That was too big a gap to be closed by deflation. Therefore, "Where a price reduction of the magnitude indicated above is necessary to expand exports, it would in many cases seem possible only through an adjustment in the exchange rate."¹

Series of Devaluations:

The widespread devaluation of currencies that took place in September, 1949, was the most far-reaching in any comparable period in recent times. Twenty-nine countries of whom 19 were members of the Fund depreciated their exchange rates. The countries that devalued their currencies in September accounted for approximately 65 per cent of the total world trade, as measured by world imports in 1948. These exchange rates were adjusted on this vast scale in recognition of the great changes that have taken place in the relative international economic position of large parts of the world during the past ten years, chief of them being the post-war distortion in international payments. To facilitate a high level of trade and a closer balance in international payments, with less reliance on restrictions and discriminations and less dependence on extraordinary foreign aid, the members of the Fund devalued their currencies.

A glance at the balance of payments of the United States would indicate the magnitude of the problem. The surplus of the United States with the rest of the world for goods and services in 1949 was $6.2 billion. This surplus, about half of which represented the surplus with OEEC countries in Europe, was distributed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Billion $</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States surplus on goods and services in 1949 with OEEC countries</td>
<td>3.1</td>
</tr>
<tr>
<td>With other sterling area and OEEC dependencies</td>
<td>0.5</td>
</tr>
<tr>
<td>With Latin America</td>
<td>0.7</td>
</tr>
<tr>
<td>With Canada</td>
<td>0.5</td>
</tr>
<tr>
<td>With the rest of the world</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>6.2</strong></td>
</tr>
</tbody>
</table>

There was a substantial decline in the gold and dollar reserves of the United Kingdom from $2,696 million in December, 1946, to $1,856 million at the end of 1948. In the three months, April-June, 1949, gold and dollar reserves fell by 14 per cent to $1,651 million. In the eleven weeks from June 30 - September 18, reserves declined further by nearly 20 per cent to $1,340 million. Devaluation of sterling seemed the only course. The decision of the United Kingdom to devalue sterling was a signal for a general world-wide adjustment of exchange rates in relation to the United States dollar. In view of the fact that the United Kingdom
is a keystone in the arch of international monetary relations and world trade, the timing and extent of sterling devaluation became a guide to others. Consequently, when the new rate of United States $2.80 (as contrasted with the old rate of $4.03) was agreed for sterling, most of the sterling area depreciated their currencies proportionately. But countries like Belgium and Canada, whose payment problem was one of large deficits with the United States and equivalent surpluses with the European countries depreciated their currencies moderately with respect to the United States dollar and thus appreciated considerably with respect to sterling, other European currencies and the currencies of the related areas.

In almost every respect, except dollar payments, the economic situation in Europe continued to develop favorably during 1949. Industrial and agricultural production increased in OEEC countries, the former by six per cent over 1948. Inflation was kept well under control and money supply relatively stable. With this improvement in the supply and monetary situation, rationing and other controls were relaxed. The groundwork for monetary stability had been laid in Europe.

In 1948, the European deficit for goods and services with the rest of the world, except the United States, was $1.8 billion; by 1949, the deficit had been transformed into a surplus of $200 million. However, the deficit with the United States remained quite large, to eliminate which, these European countries resorted to three courses of actions:
1. To increase their exports to dollar markets by reducing their export prices relative to those of the United States;

2. To decrease their imports from countries requiring dollar payments;

3. Through the change in relative export and import prices, to induce a shift in the imports of other countries to European sources of supply and to induce a shift of their own imports to non-dollar sources of supply.  

The European devaluations also brought about some improvement in the intra-European payments situation. The changes in the relative values of European currencies have made possible, in general, a better balance in intra-European payments and some easing of intra-European trade restrictions.

The relatively large change in export prices in Europe, compared with those in the United States, offers a strong inducement for the substitution of European for United States sources of supply. Accordingly, the monthly average values of the imports (f. o. b.) of the regions in Asia and Africa from the United States fell sharply after the devaluations:

<table>
<thead>
<tr>
<th>Month</th>
<th>Average Value of Imports (f. o. b.) in Million $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan. 1 - Dec., 1948</td>
<td>279</td>
</tr>
<tr>
<td>Jan. 1 - Sept., 1949</td>
<td>287</td>
</tr>
<tr>
<td>Oct. 1 - Dec., 1949</td>
<td>222</td>
</tr>
<tr>
<td>Jan. 1 - March, 1950</td>
<td>192</td>
</tr>
</tbody>
</table>

The immediate effect of devaluations in Asia and Africa, therefore, had been to improve the dollar payments position.

The devaluations began to improve the payments situation in all parts of the world. The United States balance of payments situations in 1948, 1949, and 1950 confirms this belief, whereas in the last quarter of 1948 and the first quarter of 1949, the United States surplus for goods and services was at an annual rate of $6.8 billion, in the last quarter of 1949 it was at an annual rate of $4.4 billion, and in the first quarter of 1950 at an annual rate of only $2.6 billion. About half of this change was the result of the reduction in the deficit of the OEEC countries and of the overseas areas associated with them. In the six months following devaluations, the rest of the world acquired $700 million in gold and dollar reserves from the United States. The United Kingdom's dollar reserves rose from $1,688 million at the end of 1949 to $2,422 million at the end of June, 1950. The Fund in this context exhorted the members to restore confidence in the monetary stability through sound financial and trade policies, to encourage the public to resume saving in customary forms and to facilitate the noninflationary financing of investment.

Exchange Restrictions after the "Transition":

At the time the Fund was established, the signatories to its Agreement disapproved of exchange restrictions. It was agreed, however, that
in practice such restrictions might need to be retained for what was optimistically termed as a "transitional period"; the Fund was enjoined to report on whatever restrictions were still in force, "not later than three years after the date on which the Fund began operations, and on each year thereafter." The first Report on Exchange Restrictions, dated March 1, 1950, of the Fund showed that only the United States and neighboring Central American Republics were able to undertake the obligation to grant unlimited free treatment to current payments. Belgium and Luxembourg made substantial advances towards convertibility.

A sad commentary on the extent and complexity of the exchange control blight is provided by Part II of the Fund's 1950 Report. This lists the restrictions imposed by the separate member countries and gives only summarized particulars. In general, the Fund accepted this disappointing record with good grace. It confined itself to very meek expressions of disapproval about restrictions motivated by protective rather than balance of payments considerations and about the tendency to relax restrictions by specified currencies rather than by categories of international transactions. Anybody who hopes to find in this document a clear expression of the Fund's attitude towards exchange restrictions will be disappointed. The authors of the Report so obviously feared to appear as ineffective Canutes, that they were able to do little more than utter some rather banal comments on what they devoutly hoped was
a trend of improvement towards greater international economic equilibrium. ¹

**European Payments Union:**

The Agreement for Intra-European Payments and Compensations for the period July 1, 1948 - June 30, 1949, while allowing a high level of intra-European trade, had continued the bilateral character of the pattern of trade and payments. There were large discrepancies between the drawing rights granted under the Agreement and those actually needed, so that some drawing rights remained unutilized, while in certain directions trade restrictions had to be imposed.

To remedy these defects, a new Intra-European Payments Agreement was adopted on September 7, 1949, for the period July 1, 1949 - June 30, 1950, which added some elements of flexibility to the previous arrangements. A debtor country was to be authorized to use 25 per cent of its drawing rights to cover a deficit that might arise with any of the participating countries, and the corresponding dollar aid was set aside to be allotted to the country against which multilateral drawing rights were used. The total amount of local currencies at the disposal of European countries to pay for their intra-European deficits was the equivalent of $875.7 million.

The initial fears of the sponsors that the Fund was jealous of the European Payments Union (EPU) as the latter might prove to be its rival were set to rest by the Fund when it declared to its observer to the EPU conference in Paris in 1950 that:

1. The Fund should give assistance in the formulation of a satisfactory payments arrangement compatible with its purposes;

2. That regional payments arrangements should be so formulated as to facilitate convertibility; and

3. Inflation should be effectively met and reserves should be built up.

The EPU provided for all bilateral payments positions at the end of each accounting period. Each member country reports its position with every other member to the Bank for International Settlements at the end of each month. The BIS then determines for each country its "accounting surplus or deficit" for that month, by calculating the sum of its bilateral surpluses and deficits. The BIS thus maintains the accounts of the Union and also acts as a clearing agent.

The EPU was a step forward in achieving multilateral trade and payments in Europe and so is working towards the objective of the Fund. Therefore, the lack of cooperation which the Fund showed in the beginning was unjustifiable.
When the Articles of Agreement were drawn up, it was believed that after three years of its operations, the members would remove all restrictions and controls on foreign exchange and trade. In the last chapter it was seen, after a review of the situation on exchange restrictions at the end of the specified period in 1950, that the Fund seemed like an "ineffective Canute." Unfortunately, the same situation recurred the next year as seen from the second Report on Exchange Restrictions published by the Fund, where it announced that the removal of "inappropriate exchange rates" since September 1949 should make it possible for much greater progress to be made towards multilateral and unrestricted world trade. It is interesting to note that when the Fund argued in favor of depreciation, the Economic Commission for Europe in its report, published at the same time (May, 1951) as the above-mentioned report of the Fund, unexpectedly pleaded for appreciation of Western European currencies in the hope that the internal prices of imported goods would be cheaper. The rearmament launched as a result of the Korean War and imports were to be three to four and one to two per
cent, respectively, of the national incomes. Revaluation upwards of the currencies of the manufacturing countries of Western Europe would, the ECE believed, "cut short" the adjustment of the price relationships between manufactured goods and raw materials. This contradiction in counsels arises from the fact that the Fund had its eye on long-term solutions; whereas the other institution had its eye on short-term ones.

The Fund report on exchange restrictions, published in 1951, assesses world trade prospects as the winter of acute dollar shortage had apparently passed then. The Fund believes that removal of trade restrictions would have a short-run anti-inflationary effect by increasing the quantity of goods available for domestic consumption. But its main theme is clearly that a more economic use of world's resources would have benefits outlasting the present emergency. The second report also is a summary of the existing exchange restrictions and states that consultations with the Fund concerning the retention of these exchange restrictions have started.¹

The Annual Report of 1951 of the Executive Directors mentions only one solid achievement and that is the purchase by Brazil of $10 million from the Fund. It also appeals to members to fight inflation effectively.

¹ "Two Voices on Exchange Policy," The Economist, June 2, 1951, p. 1315.
By March 1952, the so-called "transitional period" was over. But was the transition over? Unfortunately for the world, the 1952 Annual Report of the Executive Directors had this to say:

The attainment of a stable international equilibrium, however, still eludes large parts of the world, and there has been little secure or sustained progress toward the Fund objectives of unimpeded multilateral trade and the general convertibility of currencies.¹

Advising the members to relate their domestic policies to external ones, the Report says,

When there is excessive demand for all resources, the incentives to undertake the transfers of productive resources that may be necessary if long-term external equilibrium is to be established are seriously weakened.²

In the matter of new techniques, the Fund was barren of ideas. It was still guided by the rigid philosophy of 1944 when in 1952 the world was faced with the problem of inflation. Wider tolerance of exchange fluctuations is certainly desirable. Besides, the Board of Executive Directors of the Fund is too unwieldy a body. The information it receives is disseminated to all the member governments. At this rate, it can never command the confidence of any member and would never be the repository of confidential information, which is so essential for the successful working of such a technical institution as the Fund.

² Ibid., p. 5.
It is gratifying to note that the year 1952 saw some progress when the Fund's Managing Director said that the Fund was to be regarded more as a provider of foreign currencies rather than a severe critic of applications for assistance. This flexibility of approach is to be seen in its novel "stand-by credit" arrangement granted to Belgium. Under this arrangement, Belgium was given access to $50 million of the Fund's resources. This was a very wide interpretation of the Articles of Agreement and was welcomed by the EPU. This stand-by credit device had originated as a reaction to the view of the members that they cannot rely on Fund assistance in case of need.

The third Report on Exchange Restrictions of the Fund was not encouraging. It reported that at the beginning of 1951 some progress was being made towards the removal of restrictions, but at the end of the year, and the beginning of 1952, the pendulum swung right back towards more stringent restrictions. It went on to add that 44 out of 51 members at that time were consulting the Fund about the retention of these restrictions.  

However, the members were fighting the dollar shortage problem as evidenced by their balance of payments situation.

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The 1953 Report contained the usual good advice to the members. It reported no progress towards convertibility. To those who argued that this could be achieved only through the removal of dollar shortage, the Fund replied that a move towards convertibility would be contributing to the pattern of world trade, which in turn would relieve dollar shortage. The Fund's advice was of no great help to the countries who needed financial help.\(^1\) The Fund, however, with its inadequate resources and rigid adherence to the Articles of Agreement felt that it had to make credit available only to cover short-term difficulties; deep-seated maladjustments were to be removed by occasional departures from exchange stability. If it had more resources it could be more liberal in its administration. In this context the official British resolution for more reserves at the annual meeting of the Board of Governors of the Fund in 1953 was a step in the right direction.\(^2\)

The fourth Annual Report on Exchange Restrictions, like the ones that preceded it, summarized the existing situation. It did not have much to report on the progress towards their removal. In this, it attacks the exchange subsidies, export subsidies, and the dollar retention schemes practised by some Western European countries. The only relieving statement it contains is that inflationary pressure was being overcome.\(^3\)

\(^1\) "Discretion at the Fund?", The Economist, Sept. 12, 1953, p. 718.
By 1954, the financial world was heavily exercised with the thought of convertibility of sterling. Convertibility and enhancement of the resources of the Fund rank as the two most important issues from 1954 to this day (1959). So, it was but fitting that the first chapter of the 1954 Annual Report of the Executive Directors should be on convertibility. It is a sober statement of the essential conditions that must be fulfilled if convertibility was to be not only feasible but an enduring achievement.

First, it considers the present state and prospect of the dollar gap and secondly the part the Fund can play in providing the cushion of reserves.

On the existing state and prospect of the dollar gap, the Fund was optimistic. It pointed to the contrast of economic developments in the latter part of 1953 and the early months of 1954, and to the increased production of certain agricultural and industrial commodities in non-dollar countries, which made them far less dependent on dollar imports than they had previously been. The volume of United States exports tended to fall, despite a decline in the degree of discrimination applied against them. The result was that even leaving out of account economic aid from the United States, the dollar receipts of countries outside the United States exceeded their dollar payments. In 1953, the sterling area achieved an over-all surplus as well as a surplus with the dollar area. This improvement in the international situation indicated the increasing ability of non-dollar producers to compete successfully with the production of the United States. The result was an expansion of gold and dollar reserves outside the United States.
Stable prices and comparative freedom from inflationary pressures brought about this improvement. The Report adds that the following factors were responsible for the expansion of the dollar reserves of the non-dollar area: the general enhancement of productivity and expansion of dollar competing supplies in Europe and in the sterling area, which were the fruit of earlier investment and reconstruction policies; the adjustment of Europe's relative cost levels following the devaluations of 1949; and disinflationary monetary and fiscal policies, which eliminated excess demand and checked price and wage increases. By reiterating that chronic lack of balance in the current transactions of the United States with the rest of the world is a thing of the past, the Fund argues for wider convertibility which is necessary for any advance towards multilateral trade and payments.¹

On the second aspect of its role, that of providing resources, it emphasizes the inadequacy of the monetary resources of the non-dollar world, to cope with contingencies. The Report says that the Fund's policy should be directed towards protecting the revolving character of its resources, meaning that currency purchased from the Fund should not remain outstanding beyond the period reasonably related to the particular problem for which the currency was purchased. This period was agreed in 1952 to be three to five years.

It was also agreed that for drawings within the "gold tranche" members could draw on their facilities virtually without obtaining the sanction of the Fund. This decision was extended indefinitely in 1954. This was the first time that the interpretation of the Articles of Agreement had been made so elastic.

A final illustration of flexibility in its approach is provided by the fact that in 1953, the Fund, for the first time, made use of the provision in Article 5 of the Articles of Agreement. This allowed some modification of the normal limit on member's borrowing (that is, the amount that will not increase the Fund's holding of the member's currency by more than 25 per cent of the member's quota in any twelve-month period.) One of these waivers was connected with straightforward exchange transactions and two others with stand-by arrangements.

The following figures tell the story of the Fund in the three years from 1954 to 1956:

<table>
<thead>
<tr>
<th></th>
<th>Years to April 30th</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1954</td>
</tr>
<tr>
<td></td>
<td>dollars</td>
</tr>
<tr>
<td>Income</td>
<td>4,985,199</td>
</tr>
<tr>
<td>Expenditure</td>
<td>5,009,159</td>
</tr>
<tr>
<td>Deficit</td>
<td>23,960</td>
</tr>
<tr>
<td>Currency sold by Fund</td>
<td>231,290,000</td>
</tr>
<tr>
<td>Currency repurchased from Fund</td>
<td>145,106,000</td>
</tr>
</tbody>
</table>
The difference between income and expenditure shows a steadily widening deficit. Far from providing a positive contribution of scarce currencies, the Fund had become an appreciable net consumer of dollars.

The Annual Meetings of the Fund are a gain in many ways, particularly if there is a speculative pressure on any currency such as sterling. The rumors of appreciation of the German mark in relation to the pound contributed to the weakness of sterling in 1956. The United Kingdom had a favorable balance of 200 million at that time. In the Annual Meeting of the Fund, the British officials announced their determination to fight inflation, even at the cost of unemployment. The German minister announced that relationships between the pound sterling and D-mark were settled. These announcements along with a drawing of $561.5 million and stand-by credit of $738.5 million helped the stabilization of the pound sterling.

The main problem that faced the Fund in 1957 was the lack of world liquidity accentuated by the abnormal accumulation of gold in United States and German reserves. The fault lay with the countries that did not resist inflation. Also, the unequal distribution of the world's reserves was a reflection of a fundamental disequilibrium in the structure of exchange rates, and of the failure of creditor countries to adopt economic policies appropriate to their creditor status. Inflation was the culprit.
The policies of the Fund have contributed to international equilibrium, granting capital, and credit where most needed and raising it where it is plentiful. The Fund is the main instrument designed to satisfy justifiable need for liquidity. During 1956, the Fund sold to its members foreign currencies of $1,114 million, and in addition extended stand-by credits of which some $969 million remained unutilized at the end of the year. If account be taken of these unused stand-by arrangements, the Fund's operations in 1956-57 alone were greater than in the whole preceding ten years.

At the last balance sheet date in 1957, the assets in gold and convertible currencies had a value of nearly $3 billion; but nearly one-third of this was ear-marked against unutilized drawing rights. The Report for 1957 stresses the revolving character of the Fund's resources, implying the hope that these countries which had recently bought foreign currencies from the Fund (no less than 75 per cent of 1956 sales were made to the United Kingdom, India, and France) would reverse these operations and buy back their own currencies. It had immensely eased the famine in world liquidity in 1956.

The Fund will need to be tougher, particularly about drawings in excess of the members' initial "tranche" and has to persuade members to repay their borrowings if it is to operate successfully.
But the depletion of its resources in 1954, 1955, and 1956 was so
great that it called for a big increase in its resources. The American
administration agreed in principle, just before the New Delhi Meeting
of the Fund in September, 1958, that international reserves and liquidity
should be increased.

The urgent need was to increase the Fund's resources. The lack
of liquid resources and a structural weakness in the mechanism of the
international economy, i.e., the inability of the rest of the world to finance
their imports from the United States and the subsequent unrealistic
exchange rates, etc., have been responsible for the upsets in the post-
war international payments. If such an economy is to function smoothly
there must be means within it for the prompt correction of the forces
that disturb it.

In 1958, there seemed to be no crises of world payments. Twice
in four years since 1954, the world seemed to have weathered an Amer-
ican recession without adverse effects on its supply of dollars. For the
first time since 1954, the Annual Meeting (at New Delhi) was free of
uncertainties about the world's major currencies. It was in this sober
moment that the financial brains of the world had to deliberate on the
weaknesses of this institution. The two conflicting objectives of inde-
pendent domestic policies and stable rates of exchange were never pro-
perly reconciled. As stated earlier, the credit lines to be made available
by the Fund were to cover short-term difficulties; deep-seated disequilibria were to be removed by occasional departures from exchange stability. The result was a compromise with a built-in weakness. The lines of credit were neither large enough nor were they made conditional on corrective action by debtors or creditors themselves.

There was a suggestion by members that an increase of 50 per cent in all quotas in the IMF be made and that this would raise its resources of gold and dollars by up to $3,000 million--$1,500 million from the increase in the quotas of America and Canada, and $1,500 million if all the other members paid the standard 25 per cent of their additional quotas in gold. 1

The injection of liquidity on such a scale is much needed. At the end of the Fund's year on April 30, 1958, holdings of gold and dollars stood at $2,344 million, of which $884.3 million had to be set aside against unutilized drawing rights under stand-by credits. The free resources of the Fund were barely sufficient to meet one year's lending at the peak rate of $1,114 million reached in 1956-57. In 1958, drawings slowed down to $666 million.

In New Delhi, the British Chancellor of the Exchequer discussed with the Fund the timing and arrangements for repayment of the Suez drawing of $561.5 million, and the question of renewal of the stand-by credit of $738.5 million. This move was to facilitate convertibility of the pound sterling. Though complete convertibility of sterling has not

yet been reached, great progress towards this goal has been made. Many restrictions on trade were also removed. The Fund has thus gone a long way towards its objective of unimpeded world trade and multilateral payments.
PART IV

THE ROLE OF THE FUND IN STRENGTHENING INTERNATIONAL ECONOMY
CHAPTER VIII

SUMMARY AND CONCLUSIONS

The gold standard mechanism which worked smoothly until the outbreak of World War I was the nearest approach to international monetary equilibrium. But this semiautomatic system worked best in a relatively stable and peaceful world economy. It failed in the altered conditions brought about by the world wars.

Attempts at International Monetary Cooperation:

The International Monetary Fund is not the first attempt at international monetary cooperation. Ninety-three years ago the Latin Monetary Union, which was formed to regulate the supply and use of silver coins by its members, was one successful example of cooperation in the monetary field. Such cooperation continued in a variety of forms, as in the International Monetary Conference in Brussels in 1920, and later in Genoa in 1922. The establishment of the Bank for International Settlements in May, 1930, provided a convenient center for central bank cooperation. The World Economic Conference in London in 1933, prepared the way for effective, although limited, international cooperation during the next few
years in the field of foreign exchange and international payments. In the Tripartite Declaration of 1936, the governments of the United States, the United Kingdom, and France announced their intention to consult on exchange policy, to expand international trade, and to relax exchange controls, in order to avoid new exchange disturbances that might arise from the devaluation of the French franc. The governments of Belgium, the Netherlands, and Switzerland later affirmed their adherence to these principles. However, as this agreement carried with it neither any binding commitment nor created any machinery for continuous consideration of the problems, it did not have any significance. Strangely enough, no common resources were provided to enable countries to abide by the principles of this Declaration. To the creaking and disorganized international financial and economic mechanism of the 1930's, World War II added inflation, unparalleled destruction and economic dislocation, and sweeping changes in debtor-creditor positions.

While World War II was still being waged, ideas for a better monetary system were put forward. The principal objectives were to restore a properly working international monetary system with convertible currencies and with safeguards for the maintenance of exchange stability; to encourage a healthy and free flow of world trade; and to insure financial assistance to individual countries to enable them to correct maladjustments without resorting to measures destructive of national or international
prosperity. After much discussion, these main ideas were embodied in the Articles of Agreement of the International Monetary Fund.

**The Economic and Financial Conditions During the Early Years of the Fund:**

The problems of economic and financial reconstruction faced by the world at that time were of unparalleled magnitude. Inflation prevailed in all the countries. There were accumulated shortages of consumer goods, of capital goods, and of working inventories at all levels of production. In most of Europe, there were the additional huge requirements growing out of wartime destruction. An enormous amount of investment was required to start an increase of production and then to raise it to high and efficient levels within a reasonable period of time. An acute shortage of domestic savings forced countries to rely excessively on credit creation which contributed further to the inflationary pressure. The United States had to provide the major part of the capital goods and working inventories. Massive aid was thus given to Europe by the bold Marshall Plan.

**Progress of the Fund: Exchange Stability:**

In pursuit of its objective of promoting exchange stability, the Fund in June, 1947, accepted initial par values of 36 currencies. By April 30, 1958, initial par values had been agreed between the Fund and all but 16 of its 66 members. Several of those 16 members had recently
joined the Fund. Orderly exchange arrangements and exchange stability are important objectives of economic policy. The Fund has never taken the view that, once a parity is established, it must be maintained regardless of its suitability to a country's payment position. Thus, in 1949, the Fund discussed with the government of the United Kingdom the desirability of devaluation of the sterling. The devaluations of 1949 were the most extensive in any comparable period in recent times. The countries that devalued their currencies accounted for 65 per cent of world imports. The Fund has held the view that devaluation can only prepare the way for an improvement in a country's balance of payments. According to the Fund, this improvement can be realized to the maximum only by the successful policies applied to bank credit and investment, on wages and subsidies, on government expenditures and taxes. The national authorities, therefore, have become aware of the importance of monetary stability as part of the primary objectives which they pursue. They realize more and more that economic expansion with a high level of employment cannot for long be achieved if it is not sustained by confidence in the monetary unit and developed under a price and cost system which is free from artificial distortions impairing the production and distribution of goods and services. The increasing concern of the people all over the world, with the danger of inflation have forced them to accept the consequences of the policies designed to achieve monetary stability.
Exchange Restrictions:

When the Articles of Agreement of the Fund were drawn, it was recognized that special problems of adjustment would arise in what was called a "transitional period" and that certain existing restrictions would have to be permitted for part or all of this period. According to Article XIV, the members had to consult the Fund about the retention of the exchange restrictions after the "transitional period," in 1951. Ever since 1951, the Fund has been publishing Annual Reports on Exchange Restrictions. In 1958, Fund staff members visited 32 member countries in this connection. Through consultations and technical assistance, the Fund became intimately acquainted with the financial problems and the economic structure of the great majority of member countries. And it has been gratifying to find the readiness with which the member countries concerned have wholeheartedly participated in this work. This intimate acquaintance is of immense value to the Fund in its consideration of specific requests by members, such as requests for technical assistance, for access to the Fund's resources, or for approval of changes in multiple currency practices.

As of April 30, 1956, 38 of the 66 Fund members used multiple currency practices of varying degrees of complexity and importance, though in a number of countries the multiplicity of rates was almost entirely domestic in its impact or affected only a small proportion of the
country's international receipts and payments. In the 1957 Annual Report the Fund reproduced its decision (pages 161-162) reaffirming the unification of multiple exchange rates as one of the objectives of the Fund. Complex multiple rate systems harm the economies of the countries that maintain them; increasing competition in international trade has intensified the fears of some countries with unitary rates that multiple export rates might be used as an instrument of unfair competition against them, or that multiple import rates might involve arbitrary penalization of their exports. The Fund urged the members to simplify and remove these complex multiple rate systems. Some progress has been achieved so far in simplifying these complex systems because of the financial backing and technical assistance offered by the Fund. Yet, in the ultimate analysis, it is the general direction of world economic trends and the determination of the members that can bring about unification of exchange systems.

Almost every year the number of restrictive bilateral payments arrangements maintained by members of the Fund declined. This reduction was achieved either by a termination of the bilateral arrangements or by a reduction of their bilateral effect made possible by permitting the transferability of accruals of the partners' currency.

Forty-nine members of the Fund, in January 1957, maintained a total of more than 300 restrictive bilateral payments arrangements, of
which over half were agreements concluded with communist countries. Since January, 1956, however, the number of such arrangements between members has been reduced by one-third.

There is a growing conviction among the members of the Fund that payments difficulties cannot be removed by intensifying exchange restrictions, and relaxation of exchange restrictions which were made necessary by excessive import demands will ultimately depend on the success of appropriate credit and fiscal policies in eliminating monetary inflation.

The Fund has, from time to time, deprecated external transactions in gold at premium prices as these involved exchange transactions at depreciated rates and diverted foreign exchange earnings away from official reserves.

**Convertibility:**

It has also declared that full convertibility of currencies is one of its objectives. If the currencies of all the great trading countries were made convertible, trade and payments discriminations for payments purposes would soon disappear since no country would find it worthwhile to discriminate on a currency basis if all of its payments were made and received in equivalent currencies, that is, convertible currencies.

In this context, dollar-sterling convertibility is a great achievement. Only ten members in the dollar area have declared formally the
convertibility of their currencies. Most of the Western European countries, as West Germany, have gradually given their currencies transferability rights over a wide area. The transferability of sterling has been for some time extended to practically all non-dollar countries.

Progress has also been made toward reducing discrimination against dollar imports, in practically all countries whose currencies remain inconvertible. In Western Europe, also, dollar discrimination is negligible or nonexistent.

Though United States government expenditures abroad are still an important item in the international balance of payments, the dollar earnings of the rest of the world are large and they may be expected to continue to grow. Given a continuance of these favorable trends, it should be possible to establish and maintain a strong and balanced pattern of international payments under the heightened competition of convertibility. Thus, the Fund has played a very effective and useful part in bringing about the dismantling of various exchange restrictions, promotion of convertibility, and exchange stability. There is a striking contrast between the situation today and the situation of 13 years ago when the Fund was established.

The Fund's Exchange Operations:

The Fund was provided with resources in gold and in the currencies of its members, with each member contributing in proportion of its quota.
Quotas also regulated the rights of members to draw on these resources for short-term financing. On April 30, 1947, the Fund held $1.3 billion in gold and the equivalent of $2.1 billion in United States dollars and other convertible currencies. The first Fund transactions were made after this date, and by the end of 1948 there had been a substantial number of transactions totaling $676 million. In a number of European countries, however, the general economic and financial situation became very critical, and in April 1948 special assistance was provided for these countries by the Marshall Plan. The OEEC was set up in Paris as a part of this plan and, subsequently, for the settlement of intra-European balances the EPU was set up. Through the mechanism of the EPU, credit was extended to a maximum of $1.5 billion. This greatly eased the liquidity of members. Many countries in the sterling, French franc, Belgian franc, and Dutch guilder areas also settled their European payments and their payments with one another via the EPU. Because of this special assistance to Europe and the relatively large monetary reserves in other parts of the world, there was little reason for members to draw on the resources of the Fund.

From the point of view of business activity, the years from 1949 to 1955 were lean years for the Fund. Total transactions in this six-year period came to only $542 million, or 20 per cent, less than in the two years 1947-48. In 1950 there were no transactions; and in a number of
years drawings were very small—$35 million in 1951, $62 million in 1954, and $28 million in 1955. However, these years were important in other respects. In this period the working methods became fully organized, annual consultations were carried out under Article XIV with countries maintaining exchange restrictions. Forms of technical assistance to member countries were developed and policies and principles for the use of the Fund's resources were agreed upon. The fiscal year 1956-57 reached a new high of $1,114 million though it declined to $666 million in 1958. The total assistance granted by the Fund from 1948 to 1958 amounted to a little over $3 billion.

One of the provisions that safeguards use of the Fund's resources by all members is the limitation that, unless there is a waiver by the Fund under Article V, drawings by any one member in any one year shall not exceed 25 per cent of its quota. As trade has grown and swings in the balance of payments have therefore widened, the Fund has increasingly used the waiver privilege in order to meet the realistic needs of its members for drawings. From January 1953 to July 1958, 60 out of the 75 transactions were granted waivers. In terms of amount, the waivers were granted to transactions of $1,840 million out of a total of $2,228 million. The use of waivers indicates that members quotas are now on the low side in relation to the intentions of the signatories of the Articles of Agreement at Bretton Woods in 1944, which in turn were based upon trade data relating
to the 1930's. The Fund emphasized the revolving character of its resources by asking the members to repurchase within three to five years. It is interesting to note that of the $3 billion assistance granted by the Fund, an amount of $1.2 billion has been repurchased.

The stand-by agreement initiated in 1952 and the development of principles relating to drawings in different "tranches" have helped the members to get maximum financial assurance from the Fund. Since 1952 a total of 19 members have participated in stand-bys. This gradual formulation of practices and principles gave an impetus to the activities of the Fund in the latter half of 1956. For the two years up to the end of April 1958, the Fund transactions reached the total of $2.3 billion (including unused amounts under stand-by arrangements), an amount equal to nearly two-thirds of all the transactions of the Fund since its inception. About 92 per cent of the currency sales was made in United States dollars.

The most conspicuous transactions of the Fund were granted to the United Kingdom (involving a drawing of $561 million and a stand-by of $739 million) in connection with the Suez events in late 1956, and to Denmark, the Netherlands, Japan and India (involving drawings and stand-bys amounting to $570 million), to meet the pressure on liquidity due to world-wide boom in the course of 1957.

To the Latin American Countries it granted assistance to help the stabilization programs and bring about a simplification of the exchange system.
It has been said by critics like Hawtrey, that the Fund was mainly conceived to play a part during recessions and depressions. As a matter of fact, by far the largest total of Fund transactions to date arose in the boom period of 1956-57. It is true that this period included the emergency of the Suez crisis, but the currencies in Europe most immediately affected, namely, the sterling and French franc, were already exposed to other stresses and strains. The one outstanding feature of the recession in the United States has been that in the first six months of 1958 there was an outflow of gold from the United States monetary gold stock to the extent of $1.5 billion, which more than reversed the inflow of 1957. It cannot, however, be said that a United States recession need not necessarily reduce the supply of dollars, as it depends on United States credit, fiscal, and spending policies. The conclusion from all this can be that the Fund must remain prepared for diverse contingencies, many of which cannot clearly be defined in advance.

Case for Increased Resources:

Net available gold and United States dollars, Canadian dollars, and Deutsche marks now are about $1.7 billion. It is clear therefore that there is no longer any great margin for the Fund to grant fully that financial assistance which, under its present policies and practices, should be available to its members. It is pertinent to note that the resources of the Fund constitute a much smaller proportion of international trade now
than when the Fund was established. Exports in 1956 were four times as great as in 1937-38. In 1956, even after increases in a number of small quotas, there were 36 countries with quotas equal to or less than 10 per cent of exports. At the time of Bretton Woods, there was a fear of post-war depression. No one envisaged that world export prices in 1957 would be almost 150 per cent higher than in 1937. Though the physical volume of world exports fell by seven per cent from 1937 to 1947; in the next ten years it increased by 90 per cent. There is thus a real case to increase the resources of the Fund, if its objectives are to be most fully realized. An expected increase of 50 per cent in the quota of each member and the amount of gold becoming available for monetary purposes from current gold production (about $700 million a year) will considerably ease the liquidity and reserves position of the world. (At the end of 1957, the official reserves of all countries outside the communist area were $52.9 billion.)

Fund Represents A Valuable Cooperative Element:

Many criticisms of the Fund cited by economists like W. M. Scammell\(^1\) pertaining to its inactivity in its first decade, to the necessity of a contractual obligation on the part of members, to repurchase the currencies at a specified date, and to the need felt by many that the Fund

should stand ready to supply currencies to its members in a more liberal way, etc., which seemed valid in the first seven to eight years of the Fund, no longer seem to hold ground as seen from its activities and transactions from 1956 to 1958. Also, having observed the very effective way in which the Fund saved the international exchange structure from collapsing during the crucial times of Suez crisis, such general criticisms as "this institution was designed to deal with the problems of a by-gone era and that it is time for another Bretton Woods Monetary Conference..." seem unjustifiable and ungenerous.

Even the criticism (of Scammell and others) that international cooperation, rather than American paternalism, should motivate Fund decisions is grossly exaggerated. The pre-eminently dominant position of United States cannot but significantly influence the decisions of any international institution.

The Fund represents a very valuable cooperative element in the international economy, and a great advance from anarchic (or chaotic) conditions that preceded it. Now, the countries are willing to take stricter measures than if they had to rely solely on their own resources. They seem to be encouraged by the knowledge that a second line of defence is available. Therefore, they exert more discipline than if there were no

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Fund to draw from and consult with. It is coming to be recognized more and more as a source of credit which is available only to those member governments that have satisfied the Fund of their intention and their capacity to restore balance in their monetary affairs. The Fund thus helps to restore some measure of that international consensus and monetary discipline by which the gold standard maintained balance before World War I, and it can supply the credit to facilitate the adjustments that are required. The granting of aid will prolong and worsen the unhealthy developments, as seen from history. The aid-receiving countries do not feel compelled to take corrective measures to bring about internal monetary stability on which depends largely the international monetary equilibrium. The Fund thus affords an economic means of reinforcing the stability of international economic relationships in general, and of the exchange rate structure in particular.

The extent to which the Fund can discharge these most important responsibilities depends upon the consent of its members, the wisdom of its policies, and the amount of its resources.
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