

INDIA AND THE WORLD

No. II

Bretton Woods and After

By

V. S. KRISHNA

COUNCIL OF WORLD AFFAIRS

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Economic reconstruction based on full employment and increased living standards in all countries is the urgent need of the day. This would require international co-operation in the economic sphere. The Bretton Woods monetary and Financial Agreement (1944) is a manifestation of the desire of nations to co-operate in this reconstruction. Dr. V. S. Krishna discusses the issues involved in Bretton Woods together with the consequences of the Anglo-American Loan Agreement generally and with reference to India. Dr. V. S. Krishna is Professor of Economics in the Andhra University, Waltair.

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The two great World Wars of this century have been responsible for the presentation of many schemes for the reconstruction of the world's political and social order through international action. The attempts made during the Second World War differ from those of the First War in two respects. During the earlier war, informed opinion showed the need for reconstruction of the political order on the basis of democracy and national self-determination; in the later war a new emphasis was placed on economic reconstruction based on full employment and increased living standards in all countries. Whereas in the first war no comprehensive scheme for a national economic order was formulated and international action to meet immediate and pressing economic needs was begun only about two years after the war, during the course of the second war itself schemes were discussed and agreement was reached in the matter of international action in several of its aspects.

The main objectives of international co-operation in the economic sphere were outlined in the Atlantic Charter. These are access on equal terms to the trade and raw materials of the world, improved labour standards, economic adjustment and social security. Subsequent Conferences and Agreements stressed the importance of the part played by international trade in realizing these objectives. The parties to the Lend-Lease Agreement accepted the obligation to take national and international measures to promote expansion of production, employment and exchange and consumption of goods and to eliminate all forms of discriminatory treatment of international commerce

and to reduce tariffs and other trade barriers. The International Labour Conference held in Philadelphia in 1944 recognized the great contribution that international exchange of goods and services could render to higher living standards and to higher levels of employment and recommended the adoption of measures to expand trade.

The emphasis now placed on the need for international trade on a multilateral basis represents a reversal of the policy followed by many nations during the inter-war period. After the breakdown of the International Gold Standard during the second half of that period and the imposition of restrictions on international commodity and capital transactions, many economists argued that owing to permanent structural changes in the world economy, international trade would in future play an ever decreasing part in the economy of nations. It was argued that the cessation of growth in population, combined with improvements in agricultural production in the Old World and the growth of manufactures and self-sufficiency in the provision of capital in the New World, narrowed the range within which international specialization in the production and exchange of goods could be carried on for mutual advantage. According to this school of thought, the great economic depression of the thirties was the culminating point of a gradual change in basic factors rather than the result of temporary difficulties arising out of the First World War.

It is not possible to go into the merits of this argument here. It is clear that under the conditions that existed during most of the inter-war period, international trade was not without its disadvantages, the most important of which was the element of instability it introduced in national incomes and

employment. From the point of view of internal stability, different nations had, in the absence of effective international co-operation, to take measures which restricted international trade.

The recent war has changed the position in several important respects. It is now realized that the Great Powers have an obligation to increase the productive powers of the backward nations whether they view the problem from the standpoint of their own economic interest or from the strategic point of view. An economically weak country cannot defend itself and therefore invites aggression from the stronger neighbours which might lead to another world-wide war. If the existing inequalities in living standards in different countries are allowed to continue while international migrations are obstructed, international relations continue to be strained and permanent peace could not be had on this basis. Now the economically backward countries intend to proceed with their plans for industrial development whether they get outside assistance or not. If this process takes place with the co-operation of the advanced countries there would be distinct advantages for both. The backward nations could increase their income more quickly and the advanced countries could find markets for industrial equipment required by these countries. Even when the productivity of the backward countries is raised, the advanced countries need not experience any reduction in their trade, provided their productive system is flexible and could be adjusted to the changing conditions easily. Even between countries with equal living standards and similar industrial structures a wide sphere could be found in which goods might be exchanged on a mutually advantageous basis. In the coming years, export of capital goods by the

advanced countries would be of special importance. During the war, these countries expanded their mechanical industries far beyond their peace-time requirements and the transition to peace economy would be facilitated if they could find markets for their products.

The organization of a stable and expanding world trading system with advantages for all countries is now recognized to be one of the essential conditions for the realization of the main objectives of economic policy. This requires agreement among nations on several matters, e.g., on commercial and investment policies. The failure of the international monetary mechanism and the erratic movements of capital during the inter-war period were considered to be the main factors that led to the world-wide adoption of restrictive trade practices, and so it is these problems that attracted the attention of experts and governments first. Various plans were suggested by experts to re-establish multilateral trade, but discussion of these plans was at first confined mainly to academic circles. It extended to wider circles with the publication, in April 1943, of the proposals of the British Treasury for an International Clearing Union and the U. S. Treasury plan for an International Stabilization Fund which underwent several modifications and the Canadian Plan for an International Exchange Union in August 1943. These were followed by the U. S. proposal for a United Nations Bank for Reconstruction and Development. The differences in the American and the British plans led to a discussion between the experts of the two countries in 1944, and this resulted in the publication of a Joint Statement on the Establishment of an International Monetary Fund. The United Nations Monetary and Financial Conference which was attended by delegates from 44 nations met at Bretton Woods in July

1944 and an Agreement was arrived at, which was sent to the different governments for ratification.

II

The objectives of the proposed international monetary arrangements have been variously defined but the primary objective is contained in clause (ii) of the Objectives enumerated in the draft agreement, viz., '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.' Here balanced growth of international trade is taken as a means to the realization of the other purposes mentioned therein. Assuming that the other objectives are accepted by all members, it is the aim of the new organization to facilitate their realization through development of international trade on sound lines. For this purpose it is considered necessary to eliminate restrictive trade practices which were prominent during the inter-war period. After the transition period during which members might retain the war-time controls as they think necessary, they would have the right to control capital transactions but they would not be permitted to impose restrictions on payments for current international transactions. They would have to undertake not to have any discriminatory currency arrangements or multiple currency practices. Further, they might not change the external value of their currencies substantially without the concurrence of the Fund.

The inter-war restrictions on international trade were, however, due to difficulties experienced by individual countries

to balance their international accounts. In order to make the imposition or continuance of restrictions unnecessary, the Fund has to provide facilities for all members to balance their accounts without restrictive practices.

The factors that have hitherto unbalanced the international accounts of many nations and consequently made it necessary to adopt restrictive policies are several but the most important of them are:—

1. uneven distribution of international means of payment among the different nations of the world; 2. rigidity of exchange rates and 3. economic depressions. Another important factor has been international investment which will be discussed in another section.

1. Distribution of international means of payment. Every country which has commercial and financial transactions with the outside world needs a certain reserve of liquid assets which are accepted in payment by all countries in discharge of debts. In the absence of such reserves every temporary change would affect the exchange rate and disturb the economic activity of the country. The reserves enable countries to reduce the intensity of the shocks due to extraneous factors and maintain exchange rates and national income fairly stable during short periods. Before the war these reserves were made up of gold and foreign exchange, i.e., claims on foreign countries in the form of their currency, balances kept with foreign banks, short and long-term securities payable in foreign currencies. Gold was universally accepted in payments but the status of the foreign exchange varied according to the financial position of the countries to which the claims related. During the inter-

war period, these reserves were not distributed among nations according to their respective needs and the most important part of the reserve, viz., gold was concentrated mainly in the U. S. A. and France. The recent war has made the situation worse. Most of the countries outside America have suffered further losses of gold and Britain lost, besides, the major portion of her foreign securities and her debts to other countries have increased enormously. The position of most of Britain's creditors is not much better. Their reserves of gold have fallen and the sterling credits that they have built up have been blocked so that they are not available for meeting adverse balances in trade with countries outside the Sterling Area.

The most urgent problem that has to be solved is the provision of adequate reserves of international means of payment to the countries whose reserves have been depleted. As the principle of multilateral trade has been accepted, all bilateral clearing arrangements are ruled out except when the projected scheme breaks down. Restoration of gold as the principal means of payment does not come in for serious consideration after the inter-war experience. The only practical alternative is the exchange reserve system which was widely used during the inter-war period. But under post-war conditions it is not possible for most of the countries to build up reserves of foreign exchange. For this purpose they have to export more than what they import and except the U. S. A. and possibly Canada, no other important country is in a position to do it for some years to come. The purpose of the reserves would be served if these countries are assured of borrowing facilities which they could utilize when they experience temporary deficits. Every deficit in international trade for a country means

a corresponding surplus for another country and if the latter is prepared to wait for payment towards its surplus export till such time as the position of the deficit country improves, all countries could carry on trade without changing their plans for employment and national income when there is a temporary change in foreign balance.

An arrangement which is consistent with the multilateral trade principle is the granting of overdraft facilities by an international authority which could be used for meeting temporary adverse balances in relation to any country. Two variants of such an arrangement have been proposed. One is the creation of an international monetary unit and granting facilities to member countries to borrow in terms of this money upto a specified maximum to meet adverse balances. The money so created would be a mere unit of accounts being expressed in this money. The second plan which has been suggested by the experts of the U. S. A. is to arrange facilities for exchanging from a control fund, upto a specified limit, one country's currency for the currency of any other country required for meeting the excess payments to that country. There is no essential difference between the two schemes with regard to the mechanism of their operation and actually the second has been adopted. There are significant differences between the two schemes with regard to the magnitude of the borrowing facilities and other conditions which are not necessarily connected with the basis of the plans.

According to the Agreement arrived at Bretton Woods, an international Monetary Fund would be constituted to which each member country would contribute the quota assigned to it in the form of gold and its own currency and the total of these

contributions has been fixed at 10,000 million dollars. The gold part of a country's contribution is fixed at a minimum of 25% of its quota or 10% of its holdings of gold and U. S. dollars whichever is less. Each member would become eligible to purchase from the Fund the currencies of other countries upto a maximum of its quota plus its contribution in gold, provided that its purchases in any twelve months do not exceed 25% of the quota. These limits might be waived by the Fund in special cases.

The provisions relating to the purchase of other currencies with one's own currency reduce the amount of international means of payment that a country has to hold and the arrangement would enable even a poor country to avoid restrictive measures when the international drain is temporary and a breathing time is required to make necessary adjustments in case the drain is due to a fundamental change in its economic position. The richer countries which could afford large reserves of gold or foreign currencies are able to meet temporary deficits from these reserves and they keep their exchanges stable. Countries which have organized short-term money markets could obtain the same result by raising the discount rate and thus attracting foreign capital whenever there is a deficit. The proposed arrangement is an alternative to these two methods and it would be available to all members. The detailed provisions in the matter are, however, open to criticism in two respects.

Any arrangement of this kind should, in order to be equally beneficial to all countries, take their relative needs in determining the amount of accommodation granted to each by the Fund. This has been made difficult by making the quota

assigned to each member serve two purposes. It determines both the contribution of the member to the Fund and the amount of overdraft it could get in case of need. The capacity to contribute gold and the need to borrow are not related and often they move in opposite directions. The British and the American Plans proposed that factors like the volume of trade and the range of its fluctuations, national income and gold holdings should be taken into account in determining the quotas. Under the conditions that are expected to prevail for a long time to come, the only rational basis is to take the maximum possible export surplus which countries like the U. S. A. and Canada would have and fix that as the total accommodation that the other members of the Fund could obtain and distribute this total according to the range of variations in these balance of payments. In the actual determination of the quotas no simple and satisfactory formula has been used. The total of the quotas of all members has been determined with reference to the desire of the U. S. A. to limit her quota to 2,750 million dollars and in calculating the quota of each individual member such factors have been taken into account as the national income, holdings of gold, value of imports and variations in exports and finally the economic significance of each country which has actually meant its political power.

The limitation of the purposes for which the resources of the Fund could be used is also open to criticism. They could be utilized only for payments for current transactions and not to meet large movements of capital, to provide facilities for relief or reconstruction or to settle the debts arising out of the war. These restrictions have been generally accepted but it is with regard to the transfer of abnormal war-time balances that

have been accumulated especially in Great Britain by the members of the Sterling Area that there have been differences of opinion.

According to the Agreement a member country could get the balance it holds in another country transferred if they have been recently acquired and if their conversion is necessary for settling current transactions. But the country holding these balances could relieve itself of the obligation of providing for the transfer under a clause which gives power to every member country to regulate international capital movements. It has also been provided that the country holding the balances need not undertake their conversion if it is, for any reason, not entitled to purchase foreign exchange from the Fund.

The earlier Plans recognized the need for making special provisions for the conversion of these abnormal balances through the agency of the Fund. They have been accumulated recently and they might be required to meet deficits that are expected to arise from the purchase of goods by the owners of these balances. The restrictions laid on the convertibility of these balances are in conformity neither with the declarations of the statesmen of the United Nations to help the backward countries to develop their industries nor even with the more limited purpose for which the Fund is to be organized, viz., to facilitate the settlement of current transactions.

2. Exchange Rates.—The use of gold or foreign exchange reserves to meet deficits in the balance of payments is useful only when the deficit is temporary and is expected to disappear within a short time. When the deficit is due to a fundamental change in the economic position of a country in relation to

other countries, these reserves would allow the deficit countries some time to make necessary adjustments. When such changes occur, member countries have the problem of making necessary adjustments in their economy. Under the gold standard it was expected that the loss of gold or foreign exchange reserve which formed the base for the circulating media in a country would reduce the quantity of money, income and prices in the country and thus reduce the imports and stimulate exports. Such an adjustment is not desired at the present day. The only practical measure available, barring quantitative trade controls, is a change in the external value of the deficit country's currency. Such a change affects the position of not only the country that makes the change but other countries as well. While the other countries cannot object to a change when it is effected to correct a persistent disequilibrium in the trade of a country, they would naturally take defensive measures if by such a change the country tries to gain an advantage at their expense. While it is, therefore, not the intention to force rigid exchange rates on member countries and while it is recognized that changes in exchange rates should be made whenever there is a fundamental disequilibrium, it has been thought necessary to make sure that changes are made only when they are necessary and that they are made in an agreed manner.

According to the terms of the Agreement, the par value of a country's currency would be established in terms of gold or the U. S. dollar. Purchases and sales of gold or exchanges with foreign currencies should not be made at rates which differ from this par rate by more than a fixed margin and members undertake to take all necessary steps to maintain the stability of exchange rates. When there is a fundamental dis-

equilibrium, a country could change the par values upto 10% without obtaining the concurrence of the Fund. With regard to changes beyond this, the Fund has the right to object or concur, but for changes between 10 and 20% it has to give its decision within 72 hours if the member so requests. It is stated that the Fund should concur in a change if it is necessary to correct a fundamental disequilibrium. During the transition period special consideration should be shown to members who request a change.

The provisions relating to the exchange rates, when given effect to, would introduce some of the important features of the gold standard and so the whole scheme has been interpreted in some quarters as an attempt to reintroduce that discredited standard. If the rates of exchange are rigidly adhered to, the new plan would not materially differ from the gold standard. Gold would still be the regulator of value though it would not be the chief means of international payments. Besides the provision relating to the change in the par value of individual currencies, there is another which permits a uniform change in the value of all currencies by a majority of votes and with the approval of each of the members having at least 10% of the quota.

The provisions relating to the alteration of exchange rates are open to criticism from several points of view. In the first place, the term 'fundamental disequilibrium' has not been defined and there has already been difference of opinion among economists regarding the criterion to be used. The British Plan suggested that the persistence of a deficit for at least two years might be regarded as valid ground for changing the

exchange value of a country's currency. This is the most obvious criterion but it is not an infallible one. It is now recognized that there is an equilibrium rate of exchange for each level of employment. A country could have balanced international accounts and yet have large unemployed resources and if this happens as it happened in Britain from 1925 to 1930, it could not be said that there is real equilibrium. The criterion of equilibrium differs from country to country according to the stage of economic development reached and so it is necessary to give a wide definition to the conditions of disequilibrium which justify a change in the exchange rates. The British Government is now proposing an amendment which would include the level of employment as a criterion but in the case of agricultural countries it is not applicable.

In the second place, the provisions relating to the transition period are not adequate. During the war, each country's economy became independent with no regular market relationship with other countries. Fixing an appropriate rate of exchange immediately is impossible. Even if it is possible to discover a rate of exchange appropriate to conditions prevailing at a particular time, these conditions are liable to change and then the par rate previously fixed becomes inappropriate. Under these circumstances the best arrangement would be to provide for re-consideration of the rates of all countries at frequent intervals.

Further, the conditions attached to a uniform change in the value of all currencies in gold are open to criticism. Under the scheme gold is made the regulator of value, and commodity prices all over the world change with changes in the supply of gold. The danger of deflation could be avoided if the value of

currencies is changed whenever there is a change in the supply of gold but this has been made almost impossible because any important country that is interested in supporting gold could, under the constitution of the Fund, veto such a proposal. If any country does not want to change the value of its currency it should not be forced to do so. There is a specific provision to that effect. Why such a country should be given the power to prevent the revaluation of the currencies of other countries when they want it, is not quite clear.

3. **Economic depressions:**—Among the objectives of the Fund, maintenance of high and stable levels of employment takes a prominent place. Unless every country takes all possible steps to maintain employment at a stable level, the new mechanism would not work smoothly. When, in most countries, employment is maintained at a stable level, a temporary deficit in an individual country due to, say, a failure of harvest could be met by the accommodation provided by the Fund and when deficit persists due to changes in the long-term factors, it might be removed by an appropriate change in the par value of the currency. These two provisions relate to the maintenance of equilibrium in short and long periods but there is still the need to provide some mechanism by which intermediary equilibrium might be restored when it is disturbed by the failure of one or more foreign countries to maintain full employment. A depression would start in such a country or countries and if the principle of multilateral trade is in operation, it might spread to the rest of the world. The country having a depression would have an export surplus and the other countries would find the demand for their exports falling and consequently employment in their export industries would fall. If the deficit countries continue their policy of maintaining

full employment, they would increase domestic expenditure correspondingly but this would not remove the deficit in foreign payments. The deficit might be removed by changing the exchange rate but this would cause a shift in the distribution of resources within the country among industries and when the foreign demand increases the original distribution would have to be restored. Such frequent shifts are not desirable from the point of view of internal stability and so exchange variation is not considered to be a suitable method of correcting such a disequilibrium as that under consideration.

If the deficit countries (countries with full employment) possess large reserves of international means of payment or, in the alternative, they are given large overdraft facilities and if foreign trade plays an important part in the economic activity of the surplus (depression) country, adjustment is possible if sufficient time is allowed. The deficit countries would use their reserves to maintain their purchases from the country with depression and the export surplus of the latter would compensate for the original fall in domestic investment which caused the depression and this would cause expansion in internal business activity and the export surplus would disappear. But there is at least one country which does not satisfy the second condition, viz., the U. S. A. whose economic activity was subject to large fluctuations during the inter-war period. The Fund does not provide sufficient accommodation to meet the above mentioned situation.

Under these conditions, the Fund would function properly only if the U. S. A. takes more effective steps than in the past to stabilize her domestic investment. The British and the U. S. A. plans suggested some measures which are recom-

mandatory and not obligatory, to meet a situation where a country has a persistent export surplus. The proposals contained in the Agreement are more radical.

The currency of the country which has such a surplus would become scarce if the surplus continues for a time. The Fund may then purchase the scarce currency with gold or may borrow it with the consent of the government of the surplus country. If these measures are not sufficient the Fund would declare the currency scarce and would apportion the limited supply among the members according to relative needs. When once a country's currency has been declared scarce other members would be free to take measures to reduce the demand for such currency by such measures as exchange control, tariffs or quantitative controls. This means the introduction of discrimination but it is preferable to a policy of merely tendering advice to a country which does not follow an expansionist policy. When other members are likely to adopt any of the above measures, the surplus country might be compelled to take appropriate steps to increase her purchases from abroad. If defensive measures are not taken in right time, the countries experiencing deficits would find their reserves exhausted and this might lead to the imposition of restrictions on trade with other countries also which would lead to a world-wide contraction of trade. This provision is therefore well conceived and if it is intended to be made use of in case of necessity, it would meet a difficult situation. We have now an authoritative statement from Lord Keynes that the provision is intended to be enforced and the representatives of the United States are a willing party to it. It may, however, be desirable for the Fund to suggest appropriate measures to the surplus country for ex-

panding internal investment before declaring its currency scarce and if the suggested measures are not adopted, to make proposals to the other countries to increase the volume of trade among themselves to make up for the reduction of trade with the surplus country. In this way the volume of trade might be kept up and the spread of depression might be prevented.

III

Balanced expansion of trade is not the only essential condition for maintaining full employment and raising living standards throughout the world. Even a balanced growth of trade could not be had without planned international long-term investments. For raising the living standards in the backward countries, provision of long-term capital by advanced countries is necessary. The advanced countries themselves find it necessary to make investments in foreign countries in order to have stable employment at home. These countries save a considerable proportion of their incomes and unless there are investments to offset these savings, income and employment would fall. Within their territories they might not find profitable channels of investment. By radical changes in the distribution of income they might increase consumption but they might not be prepared for such changes. The other alternative is to make investments in foreign countries which would enable them to maintain high levels of income and employment in spite of large savings. Such investments should be planned by an international authority in order that they might benefit the backward countries and also contribute to the stability of international trade. One of the important factors that made the international economic transactions unstable during the inter-war period was the fluctuating international investment. In

the discussions relating to the Great Depression, the part played by the movements of short-term capital was stressed but fluctuations in the long-term investments were also responsible for it. It has been calculated that between 1929 and 1932 the foreign investments of the U. S. A. fell from about 1000 million dollars a year to 90 million dollars. This was largely responsible for the shortage in the supply of dollars which unbalanced the international accounts of many countries.

Because of the close connexion between international commodity trade and the flow of long-term capital, the U. S. Treasury published the draft scheme for a Bank for Reconstruction and Development within four months after the publication of the plan for the Fund. The Bretton Woods Conference discussed the problem of international investment along with monetary problems and recommended the establishment of an International Bank, the membership of which would be open only to members of the Fund.

The functions of the Bank are to aid the reconstruction of the areas devastated by the war, to facilitate the reconversion of productive enterprises from war-time to peace-time needs and to help economically backward countries to develop their resources. It would have an authorized capital of 10 billion dollars and the minimum capital which each member has to contribute is fixed at an amount which in most cases is equal to the quota under the Fund scheme. 20% of the subscribed capital might be called for using it in making loans and the remaining 80% would be called only to meet losses.

The Bank would make loans from its own funds and from funds borrowed from private investors and it would also guar-

antee loans made for the above purposes through ordinary investment channels. The total of the loans and guarantees is limited to the capital, reserves and surplus of the Bank.

The scope of the Bank's activity is very limited. It is not expected to displace the ordinary investment channels; it would provide capital only to such sound enterprises as could prove their inability to raise the required amount through those channels. It has been calculated by Prof. Staley that the Asiatic countries alone should invest, in the next 40 years, about 270 billion dollars in order to reach the stage of development attained by Japan. Much of the required capital would be found internally but a considerable proportion should be provided by the economically advanced countries. To this must be added the requirements of the areas devastated by the War and other undeveloped countries. The foreign capital requirements for these purposes would have to be expressed in hundreds of billions and not tens. Most of the required capital would, therefore, have to be found through ordinary investment channels. The main purpose of the Bank appears to be to set an example to private investors by charging reasonable rates of interest and by making other conditions liberal.

IV.

The foregoing discussion has shown several defects in the Bretton Woods Agreement and when the two institutions have worked for some time other difficulties might be discovered, while some of those mentioned previously might be got over. If the general plan is sound, individual parts might be altered in the light of experience and to suit changing conditions. In the discussions that followed the publication of the draft Agree-

ment, it was not the technical defects that received most attention but the absence of conditions favourable for the successful working of any new international monetary mechanism. Monetary mechanism plays an important part in international trade but it is only a part of the international economic organization and if the new mechanism is to work successfully, there should be a corresponding adjustment in other parts. Further some special arrangements are considered necessary for the immediate post-war period.

The Bretton Woods Conference was aware that the Financial Agreements should be supplemented by further agreements on internal and external economic policies. It was, for instance, stated in the Agreement that the purpose of the measures outlined in it was to enable member countries to maintain a high level of employment and as was stated in a previous section, the new mechanism depends for its success on the maintenance of high and stable employment in every country but nowhere in the Agreement has an obligation been laid on member countries to adopt such a policy. The question of the tariff policy of member countries is another subject that has not been dealt with. It is not desirable for countries, especially industrially backward countries, to surrender their freedom of action in fiscal matters. Protective duties are an essential part of the plan for the realization of the ideal of full utilization of the resources of the backward territories but the use of the tariff to correct temporary disequilibria in international payments would lead to frequent changes in the channels of trade. Several advanced countries erected high tariff walls because of the instability of foreign trade in the past and agreement on the future of the tariff policies of member countries is

another essential condition for the successful working of the Bretton Woods mechanisms. There is, again, the question of common action in regard to the control of the factors in international trade that contribute most to instability. The trade in primary commodities, for instance, is highly unstable and it is the wide fluctuations in the prices of these commodities that create difficulties for agricultural countries. Measures for the orderly production and marketing of such commodities are therefore necessary if international trade is to develop in an orderly manner.

The Bretton Woods Conference recommended that such matters should be taken up at a separate conference. A conference on trade and employment will be held during this summer and a joint statement regarding the principles that should govern an international agreement in the matter has been issued jointly by the U. S. A. and Britain. This statement raises several controversial points into which it is not possible to go in this study. It is, however, clear that unless there is an agreement among the members of the Fund regarding their trade and employment policies, the monetary mechanism would not work satisfactorily. The critics of the Bretton Woods Agreement might with some justification argue that it is unwise to start the Fund before there is agreement on these important issues.

The problem that delayed the ratification of the Bretton Woods Agreement by some of the important countries is that of the special aid required during the transition from war economy. The provisions in the Agreement relating to the transition period are in the form of exceptions to the normal course of action expected from member countries rather than

positive measures to assist countries to get over the difficulties in that period.

The most important problem that confronts most countries today is the lack of adequate stocks of goods not only to feed the people but also to reconstruct their industrial structures. Even among the nations that have not suffered much physical destruction during the war, depletion of stocks of raw materials and the incidence of the wear and tear of the productive machine have been quite uneven. The countries whose needs are pressing are not in a position to purchase from others on account of lack of adequate reserves of international means of payment. Some countries have built up considerable foreign balances but these have been blocked and they are not available for payment to countries which are in a position to supply goods now. The credits that would be made available when the Fund starts functioning are quite inadequate for this purpose. In order to establish the system of multilateral payments by removing the war-time controls at an early date, it is necessary to grant adequate assistance either in the form of gifts or loans. Provisions of food etc. to impoverished countries has to take the form of gifts and these come under the jurisdiction of the U. N. R. R. A. Loans required for these purposes cannot be based on ordinary commercial principles and therefore the machinery of the new Bank could not be used for this purpose.

Among the countries that need this form of assistance immediately, Britain occupies a prominent place. She needs large imports to feed her population and to reconstruct her productive machinery. The reserve of foreign exchange held on behalf of the Sterling Area is not quite adequate for this

purpose and further Britain cannot use it exclusively for her requirements. She has liquidated during the war about half of her pre-war foreign investments, which reduces her income from abroad, and in addition to this, other countries have accumulated about 3,500 million pounds which have to be repaid sooner or later. In the next five years she expects to have a deficit of about 1,250 million pounds on current international transactions and unless some arrangements are made for meeting this deficit and for unblocking the assets held by other countries in Britain, multilateral trade cannot be established in the near future in large parts of the world. It was the realization of this fact that was responsible for the postponement of the ratification of the Bretton Woods Agreement by Britain and for the conclusion of a series of bilateral currency agreements with Belgium, Sweden and France and the tightening of the control over the disposal of dollars in the Sterling Area.

The starting of the Fund and the Bank and an early extension of multilateral trade within a wide area of the world has been made possible by the proposed grant of loans to Britain by the U. S. A. and Canada. According to the Anglo-American Agreement, which is now before the U. S. A. Congress for approval, the U. S. A. would lend to Britain 3,750 million dollars during the next five years and Britain's payment for Lend-Lease supplies has been fixed at 650 million dollars. The total of the two would be repayable at 2% over a period of 50 years, beginning five years hence. Canada has agreed to grant a loan of 1,250 million dollars on similar terms.

The American loan to Britain might be considered from two points of view. In the first place, it is an aid to Britain to reconstruct her economy and to restore equilibrium at the

earliest possible moment in her international accounts. In the second place, it might be considered as an important step to introduce the principle of multilateral payments between countries belonging to the Sterling Area and the rest of the world. Different views have been expressed regarding the adequacy of the loan or the terms attached to it in realizing the two objectives.

The British financiers have presented figures to show that the amount of the loan by itself would not enable Britain to balance her international accounts even after the period of re-organization, i.e., five years. They take the pre-war imports of Britain and the reduction of income from overseas investments and shipping as the bases for calculation and maintain that Britain would have to increase her exports by at least 50% above the pre-war level to pay for her pre-war imports and the serving of the new loan would raise it to about 75%. As Britain specializes in the export of manufactured goods and as her exports before the war formed about 20% of the total world trade in manufactured goods, it is argued that Britain would not be able to achieve such an increase without the use of the weapon of bilateral agreements.

This line of argument is essentially static and does not give adequate weight to all the changes in the world economic situation in recent years or to future possibilities. The aim of all the schemes for post-war international co-operation in economic matters is to increase the volume of international trade and if such an increase takes place Britain's export trade would naturally rise. Britain has to face the competition of the American manufacturers in foreign markets but some of her former rivals like Germany and Japan are not in a position to

enter the field for a long time to come. The demand for capital goods from backward countries is likely to be enormous in the coming years and so it is not unreasonable to assume that if Britain reconstructs her industries with the aid of the American loans, she will be able to raise her exports to the desired level. Her productive capacity has increased to a considerable extent during the war and if she could maintain full employment, she would not only maintain a slightly higher standard of living than before but also export enough to meet her obligations on account of the food and raw materials imported and meet payment on account of her foreign debts. The latter would be impossible only if she radically alters her economic and social structure. If she adopts radical measures for the redistribution of wealth which would increase the propensity of her people to consume, she might not have a surplus to meet her foreign obligations. If she is satisfied with a moderate increase in her standard of living there would be no difficulty in building up an export surplus of the required magnitude.

Reconstruction of the British economic system is by itself an important problem from the point of view of future international trade, because Britain has for over a century played the leading part in the organization of world trade. The question of the effects of the loans is of greater importance from another point of view. The countries belonging to the Sterling Area, which includes several important countries, have accumulated large sterling balances at London and unless Britain gets adequate quantities of gold or dollars through loans or through an increase in her export trade, she would not be able to release these balances and make them convertible freely into dollars or other currencies. Like Britain, her creditors need immediately

goods that could for the most part be obtained from dollar sources and even after normal conditions are established and Britain is in a position to export goods, these countries would like to have a real choice with regard to the country from which they purchase goods with these balances. If Britain is placed in a position to offer whatever currency that these countries require in exchange for the balances, multilateral trade would be extended to a wide area in the world.

The Anglo-American Agreement does not permit the use of any part of the loan amount or offering the facility of converting the sterling balances into dollars. Britain has, however, undertaken obligations which go beyond those imposed by the Bretton Woods Agreement. Members of the Fund need not completely remove controls over foreign exchange transactions during the period of transition and they could retain control over capital transactions even after that period. According to the Loan Agreement, Britain undertakes to make arrangements, not later than one year after the Agreement comes into effect, for the convertibility of sterling obtained through current transactions in future into any other currency. Further, when the sterling balances of her creditors are released, they should also be made so convertible. With regard to these assets Britain has undertaken to conclude agreements with the concerned creditors. The terms of settlement would vary according to the special circumstances of each country but with regard to the members of the Sterling Area, it is intended to release a certain part immediately and make it convertible into any currency for settling current transactions, to release a second part in instalments spread over a period of years beginning with 1951 and to write off the remaining part.

This last provision in the draft agreement has given rise to considerable criticism in some of the countries which own the sterling balances, especially India which is the owner of the largest part. It might be considered natural for a debtor to try to get his debt reduced and for a new creditor to desire a reduction in the previous obligations of his debtor to make sure of the repayment of his loan but the point at issue is, whether the U. S. A. is justified in lending her support to the proposal to scale down the credits built by all the members of the Sterling Area. During the course of the negotiations for the Anglo-American Loan Agreement, the U. S. A. has been reported to have taken the view that the needs of each country should be taken into consideration in post-war settlement among the United Nations. Whether the term 'need' is interpreted in terms of the restoration of the pre-war living standards or in terms of raising those standards above the pre-war level, there is no case for scaling down Britain's debt to India. The accumulation of these balances has involved greater sacrifice than the U. S. Loan to Britain and the use of the balances is much more important for the future prosperity of India than the loan amount is for the prosperity of the U. S. A. For raising the living standards which is the objective of the new international institutions started under the leadership of the U. S. A., India needs not only the existing assets but also considerable foreign capital. If the present assets are written down larger amounts have to be borrowed from abroad and this would increase the future burden on India.

The Government of India have, however, made it clear that they are not a party to the Agreement and that they have not accepted the principle of scaling down. It is not likely that Britain would unilaterally decide to reduce her obligations,

though there have been many precedents for the repudiation of foreign debts by debtor nations. She might however ask India to choose between the reduction of the debt in which case India would be allowed to convert immediately a substantial part into other currencies and maintaining the debt at the present level when facilities for the conversion of the assets would not be provided for a long time or at least the repayment would take place in small instalments spread over a long period.

If India is compelled to choose one of these arrangements, she has to take into consideration several factors before making a decision. She has firstly to consider the urgency of her requirements regarding foreign goods. The time required by Britain to build up an excess of exports over imports is another factor. Lastly, we have to form an estimate of the dollar and gold resources that India could get immediately if the principle of scaling down is accepted.

It is clear that India needs capital goods urgently and that these requirements might be met more quickly from dollar sources than from sterling sources. Thus the immediate convertibility of sterling into dollars might enable India to obtain some capital goods in the near future. The latest information, however, shows that Britain has been making rapid progress in converting the war-time industries for peace-time production and that she would soon be able to export goods on a large scale. Further, the amount of dollar exchange that India could expect now might be only a small fraction of the total assets. Britain cannot, under the terms of the Loan Agreement, transfer any dollars from the American Loan. She could therefore give only the gold and dollars now held by the Exchange

Equalization Account which is estimated to be about £400 millions. Even if we assume that Britain could get on without any foreign exchange reserve because of the Dollar Loans and of her membership of the Fund and that, therefore, the whole of this amount is available for distribution, each creditor would get only about a tenth of the assets. India might in that case expect at most £100 millions. Actually the amount would be less.

There is, however, an important point to be considered in connection with the question of the distribution of the existing dollars and gold reserve held by Britain. This reserve is partly built up with the dollars surrendered by India and other members of the Sterling Area and when the reserve is not required to support the common currency of the Area, Britain should not treat it as her own property to be utilized according to her convenience. The members of the Area obtained sterling in exchange for the dollars surrendered but this surrender was not a commercial transaction; it was made for a definite purpose. The balance that remains after the purpose has been achieved should be distributed among the members in proportion to their original contribution. India could, therefore, rightly demand part of the reserve in exchange for an equivalent sterling credit whatever might be the terms of settlement regarding the rest of the balance.

The American loans do not immediately solve the problem of sterling balances and establish multilateral trade in all respects. It might even be argued that the terms of the U. S. A. loan have made the release of the balances more difficult from one point of view. In the absence of the Loan Agreement, creditors of Britain could purchase, with these balances, British

goods as they become available but now they would have to wait till Britain is able to build up multilateral trade in such a manner as to earn enough dollars or other means of international payment in order to make the balances convertible into any currency that the creditors might want. This argument is, however, valid only if Britain is able to produce goods required by the holders of these balances quicker than the goods which she could sell to countries that could provide dollars. The question depends on the policy of the U. S. A. If she wants an early establishment of a system of multilateral trade, she has to supply on a large scale dollars either by raising imports or through loans. With the co-operation of the U. S. A. it would be possible for Britain to make whatever amounts she could release from these balances freely convertible into dollars.

Thus, though the Loans have not given a final solution in the matter of sterling balances, they have prepared the way for a solution. As a result of these Loans members of the Sterling Area could convert whatever sterling they earn hereafter into dollars. Further, settlement of the question of the balances on bilateral lines is now excluded and lastly Britain is placed in a position to meet the difficulties of transition and reorganization.

As a consequence of the acceptance of the U. S. A. loan, Britain had to become a member of the two Bretton Woods institutions. There is no such compulsion for other countries, even of the British Commonwealth and so India could consider the question of membership in the light of her own economic interests. In the discussions relating to this question, the problem of sterling balances played a prominent part and it was assumed by many that Britain was keen on India becoming a member of those organizations. There does not seem to be

much evidence for this. In fact, in the absence of the Anglo-American Agreement, it would have been advantageous to Britain if India remained outside the Bretton Woods organizations. As the obligations imposed by the Bretton Woods Agreement applied to a member country in its trade with other members only, Britain could have attempted to settle the question of India's credits on the principle of bilateral clearing and thus forced India to spend the sterling in the purchase of British goods alone. Britain's interests have not been affected in any way with regard to this problem by India becoming a member of the Fund.

By becoming a member of the Bretton Woods organization India has not brought the solution of the problem of sterling assets nearer. Nor have her interests in that matter been adversely affected. It might, however, be argued that the discharge of obligations imposed by that organization depends on the release of these assets and so till this problem is settled to the satisfaction of India, she should not join that organization.

The obligations of the members of the Fund relate mainly to exchange control and exchange variations. Even during the last depression India did not have exchange control and if exchange control becomes necessary during the period of economic reconstruction, this has to be decided on its own merits without reference to the sterling assets. It might perhaps become necessary to introduce the principle of discrimination in relation to goods and not to countries and this could be achieved through appropriate tariff duties rather than through exchange control. India has been a party to a system of preferential trade but on the question of the benefits that India

derived from this there has been a difference of opinion. With regard to exchange variations, India's position has changed considerably since the beginning of the war. Her position in international finance has so improved that the rupee would be one of the strongest currencies in future. Moreover, during the period of industrialization when India has to import large quantities of capital goods, it might be advantageous to keep the external value of the rupee high. It is, therefore, reasonable to assume that India would not benefit by exchange depreciation.

India could, therefore, conduct the normal trade transactions according to the pattern laid down in the Bretton Woods Agreement. It is, however, with regard to the abnormal imports of capital goods in connexion with the industrialization of the country that the question of the sterling assets becomes of decisive importance. From the point of view of India and all creditor countries a settlement of this question within the Bretton Woods framework would have been advantageous. The Bretton Woods Conference thought that it was wise to restrict the scope of the new institutions and this decision has to be accepted for the present and the solution for other problems has to be attempted through other agencies. It cannot be maintained that India would not be able to discharge her obligations as a member of the Fund unless she has the sterling credits at her disposal.

A study of the first sections of this study, however, shows that the members of the Fund, especially India, are not justified in accepting the present constitution as final. The new institutions should be changed in some important respects and whether they work for the benefit of all or not depends on the

attitude of the leading countries like the U. S. A. and Britain. Whether membership of the two institutions is ultimately advantageous to India or not cannot be judged now but decision on this point need not be taken now. According to the Bretton Woods Agreement members need not remove all control during the transition period and therefore by being a member of the Fund, India does not irrevocably commit herself to the principle of multilateral trade. Whether to continue as a member or not may be decided after a few years before the question of the abolition of the controls is taken up. Meanwhile she has to watch carefully how the two new institutions work.



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