

Chapter IX

MANAGING THE INTERNATIONAL VALUE OF MONEY (Continued)The Raison d'etre of International Monetary Co-operation.

The experience under international gold standard and flexible exchanges clearly demonstrates that domestic economic stability of each country is the prerequisite for a programme of securing international stability. The factors which are responsible for bringing about fluctuations in domestic incomes automatically affect the sum total of world income. For, a country's national income is ultimately the part of the total world income. Assuming an open economy and free international exchange of goods, the national income of a country is supported by home expenditure and foreign expenditure on domestic goods (i.e. export earnings). If there is a fall in either of these two types of expenditure, the national income is bound to record a fall. The fall in the national income adversely influences the domestic expenditure on foreign goods. Thus the fluctuations in income and expenditure in one country communicate themselves to other countries. The classical theory of gold standard studied the problem from the point of view of only the adjustment of the balance of payments while the other and more important aspect viz. that of the international transmission of economic fluctuations was not given any serious attention. But under the income and expenditure approach the adjustment problem and that of the propagation of business cycle appear merely as two aspects of the same dynamic process of income change.¹

In this sense the national and international objective of

1. R. Nurske 'Domestic and International Equilibrium' New Economics Ed. S.E. Harris p.266.

monetary management is the same viz., that of maintaining a high level of national income and employment in each country so that the sum of total of these national incomes - the world income - may be the highest. The national economic objective of monetary policy is, therefore, not essentially rival but complementary to the international objectives too. The nations of the world can best achieve these twin ends by cooperation based on proper monetary integration of national and foreign economic policies. Such a basis of economic cooperation among nations fundamentally differs from the monetary policy of the gold standard and the inter-war attempts at equilibrating the balance of payments. In a way, even the gold standard system was intended to be worked out by cooperation which was, of course, voluntary. The deflationary policy in the ~~deficit~~ deficit country was to be reciprocated by inflationary monetary policy in the surplus country. But even this theoretical cooperation of the gold standard was directed towards balancing the balance of payments as its objective and not towards increasing and stabilising employment and income. The interwar period is fraught with beggar-my-neighbour policies which were undertaken to raise domestic income and employment by means of a surplus in the balance of payments. Such policies are hardly successful for providing a permanent or long-term solution. Again, even if such devices are successful for any one country, the total world employment as a whole can not be favourably affected by them.

The two systems, namely those of the gold standard and flexible exchanges, represent two extremes, one in the direction of extreme monetary internationalism and the other in that of monetary sovereignty. While the inter-war experience demonstrates that national policies which are ~~made~~ heedless of international repercussions are doomed to eventual failure, the gold standard system, despite its extreme rigidity, indicates that no international

monetary system can be worked successfully unless nations of the world are willing to follow certain rules - even if these are occasionally inopportune.¹

The New Approach - The International Monetary Fund.

The post-war approach towards international monetary problems is one characterised by cooperation to be achieved through a permanent institution. This institution provides the machinery for consultation and collaboration on international monetary problems. The International Monetary Fund, the institution raised for this purpose, aims at promoting world trade through exchange stability and establishment of multilateral payments system. All foreign transactions which hamper the realization of these objectives are to be eliminated. The Fund aims at enabling its members to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.²

The new approach is essentially based on international liquidity. Generally, liquidity in terms of international means of payments depends in the case of any one country upon the balance of payments of that country. If it is able to maintain a surplus balance of payments ^{or} ~~for a series of years~~ for a series of years, it would be able to build up good international monetary reserves which would enable that country to tide over temporary difficulties on international payments account. But for the world as a whole the liquidity will not rise. For, increase in the liquidity of the surplus country brings about a corresponding fall in the liquidity of the deficit country.

1. G.N.Halm 'International Monetary Cooperation' 1945, p.39.

2. Articles of Agreement - the I.M.F. Art.1.

A small amount of international money will serve the purpose of providing liquidity to all the countries, if it is equitably distributed among the nations of the world and again if the fluctuations in the balance of payments are short-lived and of a small magnitude. In such a case, all the countries of the world will be able to meet the deficits in their balances of payments without resorting to deflationary expedients. But it is not possible to realise such a situation due to the differences in the degree of dependence of various countries on foreign trade. Their needs for international liquidity are varying in terms of both amount and time. Under the system of gold standard and under freely alterable exchanges additional liquidity in the form of foreign short-term funds was obtained by the countries falling short of their requirements by the time-honoured instruments of the rate of interest and exchange depreciation. These foreign balances were only fair-weather friends and could not be relied upon under all circumstances. Moreover, the cost that was to be paid for acquiring foreign exchange ~~was comparatively~~ by means of these instruments was comparatively heavier, for the country concerned had to pay either more in terms of interest payments, or in the alternative, a larger amount of domestic money for the same amount of foreign exchange. The new approach of providing additional means of international payments is, to a large extent, superior to and a distinct development upon the past methods.

According to the new system, a country can purchase from the International Monetary Fund foreign exchange at a fixed rate to meet her current balance of payments difficulties.¹ On account of this external source of obtaining means of payments, the country concerned

1. By Articles of Agreement, the I.M.F., Art. 5 sec. 23.

will not be constrained to adopt deflationary measures or to devalue her currency.

Such an arrangement, no doubt, can have only temporary significance and can allow only a breathing space. In the long run no country can leave beyond its capacity to earn foreign exchange. During the time-margin provided by the Fund's resources, the deficit country shall have to increase its productive efficiency so that its cost of production is kept strictly in steps with the corresponding costs in other countries.¹

Despite this the efficiency cost of production would differ from country to country due to a number of factors such as organisation of production, trade union movements, cost of transport etc. These differences shall have to be corrected by means of adjustment of the rates of exchange. The Fund Agreement clearly recognizes the need for exchange rate adjustment. This is a distinct advance over the rigidity of exchange rate under the gold standard system. Exchange flexibility provided in the Fund agreement is controlled flexibility which is to be supervised by the Fund. No member country can alter the rate of exchange when such a policy is calculated to affect adversely the payments position of other countries. This is because an exchange rate has always a bilateral relationship. The new device of international monetary cooperation, therefore, provides for the change of par values of currencies to correct only 'fundamental disequilibrium' i.e. a disequilibrium which is not the result of temporary causes but of those that are peculiar to the country concerned and are inconvertible by other means.²

The foreign exchange rates were much distorted and strained

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1. J.M. Keynes 'Speech in the House of Lords' May 18, 1943, in *New Economics* p.363.
 2. Articles of Agreement Art.4 Sec.5.

by disequilibrating capital movements during the inter-war period. If such movements are not strictly controlled, they would thwart any attempt at international monetary stabilization. Under the post-war system disequilibrating type of capital transfers are to be controlled by the members of the Fund without any prejudice to the Fund Agreement. Such controls, however, can be exercised in a manner which will not restrict or delay payments for current transactions.¹ The Fund Agreement gives further latitude to a member country to regulate by direct controls the trade with a country whose currency has been declared scarce. An attempt at exchange control in such a situation will not be deemed discriminating. Again, in the transitional period a member country is allowed to exercise restrictions on payments and transfers arising out of even current international transactions.²

Thus, the new approach towards the management of international value of money attempts at avoiding the drawbacks of the previous systems ^{and} blends together their useful features. It is based on the clear recognition of the interdependence of national and international stability, no matter if the degree of interdependence is not the same for all the countries.

The Process of Adjustment Under the New System:
Temporary Disequilibrium.

The working of the new system is based on the creation of international liquidity for a country which is threatened with a deficit in her balance of payments. Such a deficit may arise due to a fall in income and employment abroad and due to which the exports of the country (which may be called A for the sake of convenience) may fall. The deflation of the income and employment

1. Ibid Art.6 sec.3.

2. Ibid Art.7 sec.3(b) and Art.14 sec.2.

abroad travels through the balance of payments deficits to country A which uptill now had nothing to fear in this respect. Country A, therefore, should try to prop up falling income and employment by compensatory domestic expenditure to fill up the gap created by the balance of payments deficit. But such a compensatory spending policy will enhance the deficit in the balance of payments. Country A, therefore, would obtain necessary means of international payments for the excess of imports (supposing that it has no international monetary reserves with it to fall upon) at a fixed rate of exchange from the Fund.

This is the case of temporary disequilibrium. The surplus country in the meantime, it is presumed, will recoup either automatically by the expansion of her export trade or by compensatory fiscal measures or both. As soon as the surplus country has restored income and employment fully the deficit country will no longer find difficulties for her exports. It is said in this sense that the Fund Agreement envisages a two way adjustment process.¹ Despite that, the new system imposes greater responsibility on the debtor country. This is because to compensate for the fall in employment in the surplus country, compensatory spending initially has to be undertaken by the debtor country. The policy of making available from the Fund the means of foreign payments to the debtor country makes the surplus country unduly reliant on exports. If at a particular time conditions of full employment are prevailing in all the countries except one, the falling of incomes and employments in the latter can be ascribed to purely domestic causes. In such a case the attempt at stopping the disequilibrium from becoming international by means of compensatory fiscal policy should

1. A.H.Hensen, 'America's Role in the World Economy' London 1945 pp.81-82.

start, in the first instance, in the surplus country rather than in the deficit country. The policy of compensatory spending in the deficit country would distort the trade pattern of that country, for, it shall have to create specially a domestic market for the goods formerly meant for export markets. This would involve ~~une~~ unnecessary changes in the industrial structure of the country. Again, deficit country which was originally a full employment country would be obliged to undertake unnecessary borrowings from the Fund for no fault of its own but due to the failure of other countries to maintain full employment. Meanwhile, the surplus country would have gathered a good amount of international reserves at its disposal which would supply it with a good prop to support domestic employment by domestic expenditure in case of decline of employment elsewhere without the obligation of borrowing from the Fund. The obligation on the surplus countries to take some positive action to raise income and employment comes later in the system of the Fund. The surplus country would be faced with difficulties only when the Fund declares its currency scarce and empowers other members to impose restrictions on the trade with the surplus country.¹

The new system based on international liquidity cannot offer a workable solution where recovery is prolonged or depression overtakes more than one or two countries at a time. Again, the scheme presupposes that depression will appear regularly and in rotation in all the member countries so that each one of the member will have a chance to pay up the debts from the Fund.

It is true that, as the surplus country progresses towards full employment, exports of the deficit country would increase and its deficits would disappear. But restoration of full employment

1. Articles of Agreement, Art. 7.

in the surplus country only removes the need for further borrowing from the Fund on the part of deficit country. In order that it may be able to pay up its debt to the Fund, not only that the deficit should be wiped off, but a surplus should be created subsequently. A surplus in the balance of payments of the borrowing country is possible if the other country ^{continues} domestic compensatory expenditure even after full employment has been obtained. The inflationary rise in prices thus brought about in the other country would enable the borrowing country to enhance her exports to the extent of securing a surplus. But the other country can hardly be expected to undertake such an inflationary policy in ordinary circumstances. Under those circumstances, full employment countries would be obliged to deflate if they do not want to burden themselves with accumulating international debts on current account.¹

If the full employment countries are to be given any chance to repay their debts, the surplus country must base its full employment policy more on domestic expenditure rather than on exports. And in so doing, as soon as full employment is reached, it should gradually reduce exports and increase domestic expenditure in order to support full employment at home. The new scheme fails to integrate properly the role of domestic expenditure with that of exports in raising and supporting employment. All countries should in the first instance try to maintain full employment by means of sufficient domestic expenditure.

The policy of helping a full employment country by means of placing at its disposal the means of international payments when it suffers a deficit due to recession abroad would be of doubtful success.²

Such an arrangement would drive the domestic and world economy from one state of disequilibrium to the other rather

1 T. Balogh 'Economics of Full Employment' Oxford, 1944 p.161.

2. M. Kalecki 'Multilateralism and Full Employment' Canadian Journal of Economics and Political Science Aug. 1946 p.323.

than ^{would} restore equilibrium as such.

Fundamental Disequilibrium & Its Determinants.

It may be that even after securing full employment in all the countries, deficit in the balance of payments of any one or more countries may persist. This may be due to certain peculiar conditions in the countries concerned and not due to any cyclical fluctuations abroad. Such deficits are largely explained by the disparities in the levels of ~~production~~ ⁱⁿ cost of production in various countries. This is the case of fundamental disequilibrium. The Fund Agreement provides for removing such a disequilibrium by allowing the member countries to adjust the external value of their currencies to the de facto internal value resulting from domestic policies.²¹

Two questions arise pertinently in this respect. Firstly, as to what conditions should be necessary on the basis of which it can be ^{ascertained} that a country is suffering from fundamental disequilibrium. And secondly, there is the question whether the remedy envisaged in the Fund Agreement will be an efficacious one to meet the situation.

The new international monetary system tries to secure both international and internal equilibrium by the maintenance of high levels of employment and real income in all the countries. This objective will rule out to ^a large extent the existence of international disequilibrium. Despite that, if a disequilibrium in the balance of payments of a country persists, the Fund would be called upon to decide whether it is due to internal or international factors. The Fund Agreement on this aspect does not guide us as to what should be the criterion on ^{the basis of} which a disequilibrium should be called fundamental. One of the purposes of the Fund as stated in Article one of the Fund Agreement is "to shorten the duration and lessen the degree of disequilibrium in the international balances of payments".

1. J. M. Keynes: Speech in the House of Commons, May 23, 1944 - New Economics p. 27

From this it may be calculated that the disequilibrium, which persists for a very long time, would be more than a mere cyclical disequilibrium. For this, the Fund, in the first instance, shall have to look ~~on~~ round whether there is unemployment prevailing elsewhere. If there is no unemployment elsewhere and despite that there is a deficit in the balance of payments of any one country, such a disequilibrium should be characterised as fundamental.

This is the balance of payments criterion. Against this, there is one serious objection. It may be that there may not be any deficit in the balance of payments of a country and yet there may be the case of overvaluation of national currency. This situation is illustrated by British balance of payments in the years 1925-30. There was little sign of disequilibrium in the British balance of payments and the Bank of England's gold reserves remained practically constant during those 6 years.¹ But this payments position in Britain was maintained by a contraction of total domestic income and demand. The overvalued pound was reflected not in the deficit in the balance of payments but in a serious deflationary pressure upon prices and wages. Differences in the ~~efficiencies~~ efficiency of costs of production were reflected not in the balance of payments but in the levels of income and employment. It is, therefore, argued that while ascertaining the equilibrium rate of exchange the balance of payments position along with absence of ^{a balance not more than that} any degree of unemployment at home, or unemployment at home at least not more than that in ~~the~~ other countries, should be taken into consideration.²

The comparison of relative levels of employment, however, under the new system is out of place. For, full employment, and not the balance of payments, has been already accepted as the objective of both the national and international policies. A country should not, therefore, try to secure an equilibrium in its balance of

1. International Currency Experience pp.125-26.

2. A.H.Hansen 'A note on Fundamental Disequilibrium' Appendix B to 'America's Role in the World Economy Op.Cit., p.167

payments by creating unemployment at home. For, such a policy, even if it may be successful to remove deficits initially, is calculated to export unemployment to other countries. A country should try to raise employment despite the rising deficits in its balance of payments. Such a course would be exactly in keeping with the Fund's objectives. If in so doing the deficits may grow, the situation will be one of fundamental disequilibrium and to rectify which the country concerned should be allowed to devalue.

During the period 1925-31, the overvaluation of pound sterling was reflected in the domestic unemployment rather than in a deficit balance of payments because England was not in a position to pursue expansionary policies. Her international monetary reserves were meagre in comparison with her liabilities. A lowering of the rate of interest might have led immediately to an outflow of foreign short-term funds and a corresponding loss of gold.¹

Under the system of the Fund the capital movements of especially the disequilibrating type are to be ruled out for, an individual country can impose necessary restrictions on such movements. Again, the Fund places at the disposal of the country faced with deficits additional international liquid resources. In the ~~therefore, the balance of payments~~ ^{criticism of ascertaining} context of the Fund Agreement, the existence of fundamental disequilibrium is better suited. It is further claimed for this criterion that it supplies objective unambiguous, and observable test of a fundamental disequilibrium.

The balance of payments criterion, however, should not rule out altogether the presence of any degree of unemployment. In a country where the compensatory policies of the government are not successful due to certain structural drawbacks, unemployment cannot be removed wholesale. Such policies, instead of increasing

¹Ragnar Nurske, 'Conditions of International Monetary Equilibrium in 'Readings in the theory of International Trade' Op.Cit.p.12.

employment, begin to exert an inflationary pressure on domestic prices.

In the case of such countries, it will not be inappropriate to allow depreciation which would go a long way to relieve the employment position especially in the context of full employment conditions in other countries.

In this respect 'objective unambiguous and observable test' will not be at once available. The Fund ^{shall} have to be very much watchful as to the national and international economic situations.

Devaluation under the Fund Agreement.

The recommendation of devaluation under the Fund Agreement as a measure for correcting fundamental disequilibrium is based on the classical theory of price concessions. However, in the new international monetary atmosphere, the policy may be expected to yield good results. Theoretically, the policy can be expected to make exports of the devaluing country more attractive, for, the general level of income and, therefore, the consumption standards will be higher in the importing countries in view of the general objective of the Fund to help full employment in all countries.

The remedy that is prescribed for correcting the fundamental disequilibrium, namely, devaluation, is based on much simplified assumptions like those of the classical theory. In the first place, it is assumed that the equilibrium achieved between the international prices and domestic costs by means of devaluation would be permanent or would last for a long time to come. This assumption can hardly be fulfilled, for, changes in the efficiency costs of production will be taking place constantly which will distort the old parity secured by means of devaluation. In the case of a country which is not able to conserve the advantages of devaluation, there would not be available any other means except a further resort to

devaluation. Such a policy is likely to give rise to unnecessary speculations which will adversely tell upon the income and employment patterns of the country concerned. The disparities in the efficiency costs of production are likely to be recurrent for, they are the consequence of changes in domestic as well as foreign investment and consumption outlay. The investment capacities of various countries cannot be the same. In practice there exists a wide disparity in them. The best illustration of this is provided by the present position of the U.S. vis-a-vis other countries. Huge capital outlays of the U.S. can outdo any other country in terms of productive efficiency within a very brief period and it is impossible for any other country to compete with high technical superiority of the U.S.¹ The consequence of such huge capital outlays every year can be nothing but larger quantities of manufactured goods. Such a surplus country will always be looking eagerly to other countries for markets. And if other countries are not able to absorb American exports, they will be blamed for forcing depression on the U.S.

What is really required is that the responsibility of consuming the goods should fall primarily on the producer country ~~itself~~ itself. Maintenance of domestic employment should be the function of domestic expenditure. If, instead of increasing domestic expenditure as productivity rises, the surplus country tries to keep up full employment by an export surplus, it pursues a sort of beggar-my-neighbour policy.² Simple increases in domestic expenditure either on government or private account will not suffice to meet the problem. Expenditure must be such as would increase the consumption standards of the people so that they may be able to ~~absorb~~ absorb what has been produced. In all countries

1. C.P. Kindleberger 'International Monetary Stabilization' in post war Monetary Problems. Ed. S.E. Harris 1943, p.379.
2. M. Kalecki Op.Cit. p.323.

and at all times, 'placing of adequate purchasing power in the hands of citizens, so that they will expend more, should be the main instrument of a full employment policy'.¹

Increased domestic expenditure which increases the total propensity to consume has got immense significance for the balance of payments. In recent times in the U.S. personal consumption expenditure lags far behind domestic investment outlay. In 1949-50, private domestic investment rose by 60% while personal consumption expenditure rose only by 8%. In 1950-51 both private investment and Government expenditure increased by 30% and 56% respectively while personal consumption expenditure increased only 5%.²

This indicates that the absorption of domestic goods can be increased considerably in the U.S. by a redistribution of income and increased social services expenditure on the part of the government. Such an attempt to buy up personal consumption expenditure may also increase imports of consumer or near-consumer goods providing relief to other countries by making available to them more dollar exchange. Though, domestic expenditure has increased in the U.S., ~~expenditure~~^{expenditure} the nature of this is such that it enhances balance of payments difficulties for other countries due to increased competition from American exports, rather than relieving them. The post-war fiscal and monetary policies do not seem to come to the relief of other countries. Even the Employment Act of 1946 reflects the unwillingness of the Congress

1. W. Beveridge 'Full Employment in a free society', London 1945, p. 18.
2. H. K. Zassenhans E. C. Dirks: 'Recent Developments in the U.S. Balance of Payments' Staff Papers. International Monetary Fund, April, 1952 pp. 22-23.

to take bold measures to deal with deficient demand and unemployment.¹

The Postwar relief in taxation largely benefits savings rather than consumption.² The post-war public debt policy of keeping the values of securities makes the richer sections of the country considerably liquid which liquidity cannot be expected to influence much the consumption standards of its economically better-off holders. Keeping up present levels of income by means of greater and greater investment expenditure either on private or public account is nothing but aggravating the problem for ~~tomorrow~~ tomorrow tomorrow.

The Fund should follow deeper the developments in the surplus country rather than in the deficit country. But no international body can bring about, by way of voluntary and recommendatory actions, an internationally desirable distribution of income and purchasing power ~~in~~ within a country. Here again much would depend upon the 'cooperation' of the surplus country as it was the case under the gold standard. The term 'Cooperation' implies always greater responsibility on the part of surplus countries. In this respect the new system looks too much towards the deficit countries to make adjustment. If there is ever increasing productivity in one country, devaluation can do little to mend the situation even if conceived on orthodox lines. For, even if it may give some degree of price concession to the foreign consumer, it cannot

1. S.E.Harris. Foreign Economic Policy for the U.S. Op.Cit., p.6.

2. Thomas Balough: 'The United States and International Economic Equilibrium' in Foreign Economic policy for the United States Op.Cit.p.459. The author further remarks:

"It is not likely that the trend of the tax measures can be promptly reversed when increased productive capacity necessitates a stimulus to consumption rather than saving. A fraction only of the social measures declared necessary to arrive at a distribution of the national income (especially those favouring a redistribution between the States of the Union in favour of ~~poorer~~ poorer and backward areas) has been passed. The back-log of pent-up consumers' purchasing power has melted to relatively small proportions. The sharp rise in prices since July, 1946, incompletely followed by

carry the devaluing country very far if the consumption expenditure is not rising in the importing countries. In that case, if foreign imports increase at all in the surplus country, they will do so at the cost of the demand for domestic goods the producers of which will be hit hard. Such effects are likely to aggravate the ^{difficulty of} inter-national economic ^{situation} rather than relieve it. The attempts of the Fund and the policy recommendations that it has to make in case of a fundamental disequilibrium begin at a wrong end. Though the scarce currency provisions will come into operation in case of a prolonged disequilibrium despite devaluation, these come very late and only after the economy of the devaluing country is adversely affected by the measure of devaluation.

The second difficulty which is more likely to arise and which has not been given serious consideration is the occurrence of short-term fluctuations in income round about the full employment level. Such fluctuations cannot be avoided and action to retard the further cyclical downswing can come only when a certain fall in income and employment has positively appeared. This sort of falls in national income will exert proportionately larger or smaller influence on imports according to the income-elasticity of demand for imports of various countries. A small fall in national income in the case of a country with high income elasticity of demand for imports will bring about a considerable fall in imports. The U.S. is such a country in the present context. Usually, changes in U.S. national income are associated with somewhat larger relative changes in the value of imports. On two occasions of such short-cycles these results are indicated in recent history. In 1937-38

(Note 2 continued from page 296)

a rise in wages must have further reduced the importance of this stabilising after-effect of war⁹. Ibid.

when the U.S. national income declined only by 8%, the value of total U.S. imports fell by 31% and that of U.S. imports from Europe by 33 per cent. In 1949, there was a similar minor recession. The national income in the first half of 1949 was only 2% lower than the first half of 1950. Despite that, the percentages of imports indicated wide disparities between these two dates.¹ In the case of U.S. imports, the internal economic factors are more important than external ones. Devaluation cannot be expected to prevent deterioration in the balance of payments position of other countries when there are minor recessions in the importing country with high income elasticity of demand. Again devaluation cannot be resorted to repeatedly over a short period for the purpose of removing recurrent balance of payments disequilibrium.

IN THE REALM OF REALITIES.

The new approach to solve the international monetary problems through international organization and cooperation is conceived on old and orthodox lines. It does not meet sufficiently the post-war monetary problems. These are, no doubt, taken into consideration but they are side-tracked as only transitional. In fact, the transitional problems are so complicated and ~~very~~ stupendous that without a direct handling of them normal time will be deferred indefinitely.

The fundamental characteristic of the post-second-world war world ^{is the emergence of economic} economy, policies in various countries with certain objectives to achieve. The most comprehensive economic objectives are those of full employment, especially in economically nature countries and planning for an over-all economic development in the undeveloped economics. These countries need directional control of all economic forces and tendencies. The control and regulation

1. J.J. Polak. 'Contribution of September Devaluations to the Solution of Europe's Dollar Problem'. Staff Papers, I.M.F. Sept. 1951, p. 8.

of international payments in such countries is inevitable. They cannot afford to wait and see things done by the freely working economic forces. Deficits or surpluses in the balance of payments of such countries cannot be the outcome of the free and uncontrolled transactions of the private commercial enterprises. They would be the outcome of the economic policies of the government aimed at securing certain domestic economic objectives. The new approach to solve international monetary problems through international monetary cooperation fails to take into consideration the new perspective in which the International Monetary Fund has to function. The unofficial discussions, namely the Keynes Plan and ~~which preceded~~ the White Plan ~~which~~ which preceded the ~~preceded the~~ actual Fund Agreement and also the Fund Agreement envisage an international monetary system based on multilateral clearing and free convertibility of national currencies. The temporary deficits are to be met out of the international liquid resources made available by the Fund and deficits out of fundamental economic reasons in a country are to be removed by devaluation. These remedies are based on the past experience of the working of the various exchange equalization funds established in several countries and the competitive devaluations carried on by several countries one after the other. The lessons of these past experiences cannot fully serve as reliable guides for solving the individual economic problems of various national economies.

The weapons that a country can use in order to meet her balance of payments difficulties, are inadequate for the special requirements of planned economies. Devaluation may be successful in influencing the total volume of payments and receipts. But influencing the total volume of foreign payments and receipts is not the only ~~the~~ and important objective of a planned economy. What is really needed is the control of the composition and directions of

payments. A full employment economy will need only certain types of imports which are necessary for achieving and maintaining full employment, e.g., the British import needs for raw materials. A plan for economic development in a backward economy will especially need imported capital goods. That is to say that those countries will have certain priorities of imports and exports. A non selective method like devaluation, for repressing home demand for imports would unnecessarily sacrifice essential imports. Again, it may be that in an economy of this type where the income would be steadily rising, the price elasticity of home demand for imported commodities may be very low.¹ Devaluation for such countries will not prove an appropriate remedy for solving balance of payments difficulties. No planning can be carried on unless the economy is insulated from external disturbances and exchange control is the indispensable link by which alone planned economies can be connected with the rest of the world.²

It is worthwhile to note that in 1946 when the various member countries of the Fund were to give the par values of their currencies to the Fund, several countries selected the same or a higher parity than what was before the war. The price levels in various countries had not risen to the same extent. The Fund studied in all possible details the economic situation in each member country vis-a-vis that of the world. It was admitted, then, that there were substantial disparities in the wage and price levels in a number of countries.³ Despite that, the Fund accepted the parities which were not in keeping with the national price and wage levels. This policy was based on the conviction of the Fund that in

1. T. Balogh 'The Economics of Full Employment' Op.Cit., p.144.
2. G.N.Hain 'International Monetary Cooperation' Op.Cit., p.36
3. R.F.Miksell 'The Role of International Monetary Agreements in a world of planned Economies; in Readings in the Theory of International Trade op.Cit., p.62.

the peculiar post-war conditions the exchange rates were quite unfit to perform the functions generally attributed to them. Not only that but lower exchange rates were incapable of restricting a demand for imports in the post-war economies, nor could they be of any help in increasing exports when the countries (especially non-dollar) were not able to step up exports.¹

The post-war balance of payments difficulties especially for dollar payments of most of the countries of the world cannot be explained simply by uncontrollable inflation in domestic economies and, therefore, they cannot be cured by exchange depreciation. This is well borne out by the experience realized after devaluations of September 1949. Devaluation was only one of a number of significant economic developments affecting the dollar trade balance. Some of the most important among these were an up-turn in U.S. economic activity towards the end of 1949 and during 1950 and additional export restrictions applied by many countries against dollar imports. It is interesting to note that the categories of goods whose dollar prices were most affected by devaluation, especially the type of manufactures exported by Western Europe, are the least important in U.S. imports. The dollar prices of manufactures fell to a larger extent after devaluation than those of food stuffs and raw materials. Even then, U.S. imports after devaluation concentrated on food stuffs and raw materials rather than on manufactures. There is a long term downward trend in U.S. imports of manufactures to total consumers expenditure. This clearly shows that price - concessions given by devaluation also cannot help if the exportable

 1. Camille Gutt (Chairman of the Executive Board and Managing Director I.M.F., in one of his public speeches reprinted), 'Exchange Rates and International Monetary Fund' Rev. Of Eco. & Statistics, May 1948 pp.82-83.

goods have to compete with domestic goods.¹

In the case of countries which have undertaken a planned development ~~of their productive resources~~ of their productive resources, the pressure for imports will be exercised in two ways. On one hand, they will need large imports for development purposes and on the other, due to increased domestic incomes, for satisfying the rising consumption standards. "Increases in national income tend to accrue first to the richer groups and to create balance of payments difficulties because of the propensity of these groups to import luxuries from abroad."² There is thus an unnecessary leakage in the national income which checks the national income from rising as much as it can do otherwise. The need for exchange control as a selective instrument of controlling international payments of such countries is imperative.

Exchange control has come to be associated with certain abuses and malpractices during the inter-war period. It raises 'such emotional reactions as to prevent any serious discussion. But a blind excommunication of exchange controls is not justified. The motives should be understood and every effort should be made to prevent abuses without sacrificing the real purpose which non-discriminatory exchange control can justifiably serve.³

The role of the International Monetary Fund will be all the more important even then. The Fund Authorities will have to

1. U.N. world Economic Report 1949-50 pp.175-179. There is a responsible American opinion that stopping of inflation and adjustment of exchange rates form "necessary and sufficient condition for restoring stable equilibrium in the balance of payments of any country". (G.Haberler- 'Dollar shortage' Foreign Economic policy for U.S. p.435) To this view one cannot easily subscribe. Such a view is humourously compared to that of a 'fond mother, who looking at the victory parade, proudly exclaimed, 'Look Papa, every one is out of step except our Sammy' " (T. Balogh 'Exchange Depreciation & Economic Readjustments' Rev. of Eco. Stat. Nov., 1948 p.282 Foot note 28).
2. R. Triffin 'Exchange control and Equilibrium' Foreign Economic Policy for the U.S. p.416.
3. R. Triffin ' National Central Banking and International Economy Rev. of Eco. Studies, 1946-47 No.36 p.66.

be constantly vigilant as regards the exchange practices of the members and they can sound a note of warning if abuses of discriminations develop. In this respect the Fund has actually played a significant role in the post-war period.¹ The countries which exercise exchange restrictions of one kind or the other clearly expressed their views recently to the Fund that they could secure a variety of purposes, such as restraint of over-all import demand, discrimination as between hard and soft currency countries, restriction on capital flight etc. by means of exchange control. Not only that but some countries indicated that they also tried to apply restrictions in such a way as to serve other subsidiary purposes such as economic development, maintenance of high levels of employment and also protection of certain domestic industries.² It is not possible to achieve so many objectives at a time by the adjustment of the rate of exchange. It is likely that, as the countries regain competitive strength and raise a sound reserve position, many of the restrictions will be liquidated. But a complete disappearance of exchange restrictions as ultimately intended by the Fund Agreement is impossible and even undesirable.

Full Employment & Multilateralism.

Any system of multilateral exchange of goods is based especially on two basic conditions. Firstly each country will try to purchase from other countries to the extent it is selling to these countries. That is to say it will try to equalise its imports and exports. And secondly, a country will import only those goods from others which are necessary for domestic production (i.e. raw materials) or consumption and which the country concerned is not

1. See supra p. 309

2. Fourth Annual Report on Exchange Restrictions. I.M.F., 1953 p.3.

able to meet all her needs herself. The system of multilateral trade, in view of these two conditions, can work properly only when the world's productive power is evenly distributed. If any one country has got an excessive productive capacity, it should first make domestic arrangements to absorb the goods that it is producing. Such a country should not try to support employment and income at home by means of export surpluses. Lack of demand for home-produced goods cannot be an international liability especially when full employment is already prevailing in other countries. International exchange of goods among full employment countries can be based only on the complementarity of exportable goods that these countries produce. Full employment and multilateralism can go hand in hand only when this condition is fulfilled. In ~~stating~~ limiting multilateral exchange of goods to commodities which are complementary to the economies of the countries which enter into such exchange, the countries may ~~establish~~ ^{become} initially poorer but on the whole they will be able to establish better control over the employment situation. This is no less important an objective than that of a higher standard of living for a limited number of people. If we interpret the term 'standard of living' broadly enough so as to take into account the 'psychical income' resulting from full employment and social security, the effects of the reduction in international division of labour (and hence in international trade) are certainly negligible in comparison with those of the catastrophic economic instability of the world which arises out of extreme international specialisation¹

In the present world context wherein the productive power has come to be unevenly distributed among the nations of the world, multilateral trade does not provide a solution for achieving full employment. The problem is that of securing sufficient means of

1. Royal Institute of International Affairs. Eco.Lessons, p.274.

of making international payments. The new institutions like the I.M.F. and I.B.R.D. place such means to the disposal of deficit countries but these institutions cannot be relied upon indefinitely. The help provided by them should be used with extreme caution especially when a country is not capable of increasing her repaying capacity.

The scheme of the Fund creates liquidity for a deficit country but it does not leave scope for selecting imports. This is because it is not based essentially on the complimentary character of international exchange of goods. This requires much more than mere creation of demand abroad for the goods which the surplus country is not able to sell at home. What is required is that the Fund should directly give its liquid resources to countries which most need them for developmental purposes and also should direct the country which faces the fall in demand to produce those goods which other countries essentially need. Full employment in an economically mature country in this way will not have to be supported on aggressive export policy.¹

This sort of ordering of world trade envisages the organisation of production on the basis of mutual advantage of international trade. No composition of exports which are likely to compete with ~~these~~ domestic goods of importing countries can support the industries of exporting country indefinitely. For, even if there may be established a balanced exchange of manufactures for manufactures of identical varieties it is liable to ebb and flow in the most confusing fashion in accordance with minute technical changes. It would be a lasting boon to the manufacturers in both the countries if the international exchange of their products which are of the same variety may be abolished.² Multilateralism can be

1. T. Balogh 'Economics of Full Employment' Op.Cit., p.162.

2. D.H. Robertson. 'The Future of International Trade' Readings in the Theory of International Trade Op.Cit., p.506.

reconciled with the objective of full employment only on these grounds and no other.

Yesterday, To-day and To-morrow.

Multilateral trade in the past largely depended upon the complementary nature of the goods which entered into international trade. In nineteen twenties countries of the tropical belt exported raw materials to U.S.A., U.S.K., found outlet for her exports to Europe and other semi-developed countries, many of the European countries exported to U.K. and the exports of U.K. were absorbed by the countries of the tropical belt.¹ This pattern of trade is not possible to-day when the countries in different regions of the globe become increasingly diversified in production and accordingly more self-sufficient. No one would suggest at the present juncture when India has become almost self-sufficient in food stuffs that she should import food stuffs from the U.S. in order to help that country to solve the problem of her agricultural surpluses. In the post-war period the war-ravaged countries of Europe and other backward countries like India were in need of American goods such as capital goods, raw materials, and even food stuffs. This created a dollar shortage for the whole world. But now that the European countries have been able to rehabilitate their economies their imports from the U.S. have naturally fallen and the pressure of dollar payments is considerably eased. Even in the case of the U.S., imports are composed of those goods which are either not at all produced at home or in which home supply is not sufficient.

The above facts indicate that the volume, composition and direction of international trade will depend upon the production trends and national economic objectives in different countries.

1. U.N.world Economic Report 1948 p.49.

The countries will try to so regulate their foreign trade that their national ^{economic} objectives may not be jeopardized by external disturbances. Devaluation as a method of redressing balance of payments difficulties cannot be resorted to off and on. Productivity of industry cannot be increased immediately in order to exert a downward pressure on prices. Under these conditions, unlike in the past, countries will choose to consciously regulate their foreign trade rather than manipulate the national price level or the foreign exchange value of their national currencies. This is well borne out from the experience of the E.P.U. which is an attempt at limited multilateralism and free trade. When in 1951-52 the two large members of the Union, France and Britain, accumulated debts to other members, they tried to remove their payments difficulties by restricting imports. This meant a partial reversal of the movements towards European trade liberalisation which had been the objective of E.P.U.1

No country which is maintaining a high level of employment and national income can afford to lose a greater part of its national income to foreigners than what the foreigners are contributing to its own. Countries, therefore, will act very cautiously in their foreign trade policies. A large part of future world trade will be carried on by previous agreements and understanding as is generally the case today. This does not imply that such trade deals will check the growth of international trade. The volume of trade may even increase consequent upon an all round rise in the national incomes of the world. It is also likely that such agreements and understanding among nations themselves may contribute towards an expansion of world trade rather than check it. The important point that is to be noted here is that for an individual country an expansion of world trade is not ^{an} end in itself. It is important so long as it contributes to increased employment and income. Whatever

1. I.M.F. Annual Report 1953 pp.12-13.

the money cost of production, if a country is convinced that the 'opportunity costs' (measured in terms of loss of employment and output) of producing at home the goods which are imported is nil, that is to say that home production causes a net increase in employment, it would choose to produce at home rather than to import.¹ This is exactly the ~~position~~ ^{economics} position of backward ~~countries~~ like India. Substitution of home production for imports in such countries will certainly increase employment and national income.

Whenever the objective of the expansion of world trade comes into conflict with that of full employment, it is the latter that will first receive the attention of authorities. This is not at all contrary to the objectives of the Fund Agreement. For, according to Article I (ii) of the Agreement, the expansion and balanced growth of world trade is important so long as it contributes 'to the ~~the~~ promotion and maintenance of high levels of employment and real income'. Thus the promotion of employment is the end and expansion of world trade is one of the means to secure that end. If member countries try to ~~retain~~ attain full employment by practices which may even be 'restrictive' of world trade, it is difficult to find fault with them. This has been clearly recognised by the Fund. It has realised after about 8 years of its working that the objective of balanced growth of international trade and the one of high level of employment and development are difficult to reconcile.² In such circumstances the task of an institution for international monetary co-operation becomes a delicate one.

The importance of the International Monetary Fund essentially springs forth from the fact that it provides a forum for representing

the views of member countries. Unless the member countries meet

~~periodically~~ ^{periodically} and place forth their individual points of view.

1. Royal Institute of International Affairs, Op. Cit., p. 273.
2. I.M.F., Annual Report 1952, p. 34.

their difficulties and their objectives before other members, greater economic understanding and co-operation are not possible. In the post-war period countries are ready to co-operate without ~~surrendering~~ surrendering their right to ~~manage~~ shape their individual commercial policies so as to serve their national objectives. Therefore, the expansion of international trade can be secured in the present context only by 'educating' the views of countries on the need for international economic co-operation. This point is amply illustrated by the history of G.A.T.T. which developed from a mere 'agreement' into an 'organisation'. The Contracting Parties of the General Agreement have co-operated on the basis of mutual advantage. The results are conspicuous. As a result of the world Tariff Conferences carried out under the auspices of G.A.T.T., duties affecting three-quarters of the world trade have been reduced or bound. It has become the forum for the settlement of disputes which, in its absence, would have perhaps led to sputtering tariff wars.¹

Like the G.A.T.T., the I.M.F. also has significantly contributed towards greater understanding on problems of international economic co-operation among member countries. Its advice to certain member countries to remove ~~many~~ restrictive policies in view of their sounder balance of payments position is willingly carried out. Thus, in 1953, when Belgium and Luxemburg were advised by the Fund that they should relax restrictions on dollar imports in view of their strong balance of payments position, the two countries followed the advice of the Fund and substantially increased the list of dollar imports. Norway and Finland removed their retention quota practices for, the Fund is against such practices²

1. Michael L. Hoffman, Future of G.A.T.T. Commerce (Weekly) October 16, 1954 p. 734.

2. Retention quota practices mean the practice of allowing the exporters to certain countries, especially to dollar areas, to retain a certain part of their earnings with them and to use the earnings retained thus in whatever way they liked.

Certain countries refrained from introducing retention quota practices after their consultation and discussions with the Fund, despite the fact that these countries were adversely affected by the use of such practices by other countries. The Fund expressed its concern over multiple currency practices in Greece and that country gradually eliminated such practices.¹

The Fund can gradually help to bring about conditions necessary for the expansion of world trade. Nevertheless, one can not hazard the conclusion that control^{of} foreign trade and exchange will be ~~imminent~~ abandoned by countries. In fact, at least in the ~~near~~ fore-seeable future, countries will more depend upon ~~foreign~~ foreign trade and exchange controls in preference to exchange rate adjustments or manipulation of the price level.

1. I.M.F., Fourth Annual Report on Exchange Restrictions, 1953, pp. 18-19.