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Some Financial Aspects of Current International Problems

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WHEN ONE ATTEMPTS to state what are the pressing international financial problems he implicitly assumes some general objective that is being sought. In the United States that objective is commonly taken to be the restoration of multilateral trade under the drive of the price motive—trade where individuals do the bargaining and not where the direction and terms of trade are determined politically by States that bargain among one another as such, using their economic and political power as counters in the bargaining. It may be, of course, that evolution will not be in that direction and that we shall never return to a system where getting a living will be the joint effort of individuals who are in some real sense members of one economic world. But I shall assume provisionally that our aim is to establish such a world.

Starting from this general frame of reference, it seems to me that, aside from the question of relief, the most pressing requirement is the reintegration of a cost-price structure that is as nearly world wide as possible. Prices and costs throughout the trading world must have a workable consistency so that individuals may produce for a dependable market—where they receive money that is good anywhere—and where they may go to buy what they need. An acceptable standard of life requires an elaborate international division of labor, and if trade is to be revived under a price economy, there must be a set of international price relationships that make this division of labor possible.

Of course there must be a reasonably stable international money with which the national economies can establish at least provisional contact. At the moment this is not the most pressing problem, for the dollar is temporarily stable enough for the purpose. But the problem may soon become a pressing one and we shall return to the point later.

The most pressing problems, it seems to me, are: (1) the removal of inflationary pressures in other countries; (2) the revaluation of foreign currencies so that they will reflect more faithfully relative cost structures and the terms of trade that can be expected in the immediate future; (3) the lifting of exchange restrictions and the abolition of bilateral clearing agreements. Let us take these up in order.

I

ONE SHOULD NOT MINIMIZE the difficulties of relieving internal inflationary pressure. Part of the problem is ideological. People have been taught that general monetary controls are cruel weapons to relieve inflationary pressure. There must always be more jobs than there are men to fill them, they are told, whereas general monetary controls proceed by reducing the number of jobs *below* the number of men to fill them. But if it is said that "we do not mean to use monetary restriction to the point of creating unemployment," it is replied that monetary restraints are not effective at all in mild doses and that a dosage that would be strong enough to be effective would also be destructive of prosperity. To this objection to monetary controls is added that of ministers of finance, who want to keep the annual interest cost as low as possible on the budget. Central banking has thus been largely reduced to a routine of maintaining the prices of government securities by creating whatever amount of cash is required for the purpose. There is the further objection to flexible controls on the part of those who believe restriction would reduce investment in export industries. This is the attitude of the *London Statist*, for instance.

At the same time, governments of the day, under criticism from their opponents on the left, are willing to make promises for a standard of living on which they cannot deliver. It solves the political problem for the moment to grant a money wage increase. High wages do not at all times mean general inflation, but where there is inflationary pressure to buy all the labor offered they become an integral part of the process. Moreover, where the authorities place full employment above everything else, they must see to it that aggregate demand is sufficient to create jobs at the wage rates that have been fixed.

It seems to me that there is no prospect at all for a workable national or international monetary system without returning to general monetary controls, where spending is regulated by the control of liquidity. One of the strangest doctrines of this era is the view that the terms on which money may be created have no important connection with the volume of spending.

The second important step necessary to the restoration of multilateral trade on a price basis is the revaluation of national currencies.¹ Currencies were allowed to become overvalued partly because it was feared that a drop in the exchange would accelerate internal inflationary pressures and partly because it was hoped to hold up the real terms of trade with the outside world. Also when production was so low immediately after the war, countries were not too much concerned to find foreign markets.

A firm grip on internal monetary controls is prerequisite to devaluation with safety. Nor can countries be expected to relinquish their exchange restrictions immediately. Both the new exchange rates and the lifting of exchange restrictions will have to be experimental. One of the objections to the International Monetary Fund is that it does not allow a free hand in adjusting rates.

What should be the criterion of an appropriate exchange rate? Provisionally the new rate should be one that will permit the easing of exchange controls, and finally one that will balance the international accounts without the controls—excepting capital movements not permitted. (Capital movements may have to be controlled for a long time.) There is one other condition that must be mentioned. The rate must be low enough to avoid the necessity of deflationary pressure when the controls are removed. The real danger under present circumstances is not that the countries will defend an overvalued rate by internal monetary restriction—as England did during the Twenties—but that they will devalue too little and defend the rate by exchange restrictions.

II

THIS BRINGS US to the difficulties of removing exchange controls. Suppose a country has mostly one-way flexibility in its internal cost structure. It may argue that only inflationary pressure will maintain full employment, and that even though there were no other difficulties in the way—in the form of a drop in the terms of trade—the lifting of exchange controls

¹ Since this paper was written, Great Britain and a great many other countries, both within and outside the sterling area, have devalued their currencies. While this move has apparently relieved the dollar shortage somewhat, there is a probability that the dollar is still generally undervalued in terms of foreign currencies.

would mean a more or less continuous drop in the exchange rate that would maintain equilibrium. Moreover, a drop in the exchange would in turn make it more difficult to control internal inflation. Thus they seem to have a choice among retaining their present controls, open inflation, or unemployment.

Is this dilemma real? It is now the fashion to exaggerate the amount of unemployment to which the shift from inflationary pressure to internal equilibrium would give rise. Certainly there is no historical evidence to show that the transition from inflationary pressure *must* be marked by serious deflation and serious contraction of production. The problem must be faced: a price economy must have some degree of flexibility. The risk of a small amount of unemployment seems not too great in order to get out of the present situation of suppressed and half-suppressed inflation, continuing exchange overvaluation to some degree, and the controls which these entail. The latter are certainly wasteful in the form of voluntary unemployment and the misallocation of resources. In any case the problem of flexibility cannot be avoided, since if the price economies should go down they would probably be succeeded by totalitarian economies that would deal with the matter in short order.

Sometimes it is urged that exchange control cannot be abolished because there is *no* exchange rate—or at least none that would be thinkable—that would balance the current items on the international accounts, even granting that internal inflation could be dealt with effectively. It is claimed that the rest of the world needs so much of what we have—partly because of our technological superiority over a wide range of industries—while, on the other hand, we need so little of what they can produce, that the real terms of trade under a free market economy would turn indefinitely against them and to our advantage. This argument seems quite fanciful. Countries that are short of dollars include those with a wide range of productive powers—they include producers of raw materials as well as industrial countries. Surely, with such a variety of capacities among themselves, they cannot claim that their collective need for the special products of the United States is so overwhelming that their terms of trade with us would deteriorate indefinitely.

Those who urge this argument are trying to make it appear that there is some technical cause inherently connected with the price organization of international trade, together with the shift in the pattern of trade, which is responsible for their difficulties. But the inability to produce and the poor organization of trade are in truth their ill, and overvaluation will not cure it. In fact it increases the difficulty. It is more profitable

for traders to send exports to countries with overvalued currencies than to send them to areas where dollar payment can be obtained. Countries with less overvalued currencies tend to accumulate claims on countries with greater overvaluation. In order to make some use of such balances, the authorities who hold them may require importers to buy not what is needed but what is available. The general result is that a country sends out exports that it can little afford to part with to places which do not pay in generally acceptable cash and then is unable to buy badly needed imports which must be paid for in generally acceptable cash. There is then a distortion of the structure of industry and the continued threat of an exchange crisis, which is staved off only by American aid.

The solution of this problem should not be made to appear too simple. No one country could go very far in solving it for itself. If a single country should cut its prices in terms of dollars and then sell only to hard currency areas, it would find that a large part of its market was cut off, for so many countries have few dollars to offer. The solution requires that devaluation and dollar convertibility be undertaken by a great many countries, though a most important step would be taken if the sterling area were to restore convertibility.

American aid is of course badly needed, but the question of how much aid we should extend has only a superficial connection with the so-called "dollar shortage"—the disequilibrium in the international accounts. The latter problem arises fundamentally from overvaluation and the deliberate use of reserves to buy needed imports. How much aid we should extend depends upon how much we are willing to sacrifice in order to raise European living standards. There is a certain sense in which we may consider that there is an objective test of the amount of aid required: if we try to keep the people of Europe from cracking up politically and economically, then we must help them to the utmost to maintain such a standard of life as will keep up their morale. But this is something quite different from the view so frequently expressed in the *Economist*, that the international payments between a rich and technically advanced area and one that is poor and technically backward will not balance without the use of controls. One need only consider England's own dealings with backward countries in former times to see the absurdity of this view.

III

SO FAR, WE HAVE DEALT with the adjustments which other countries must make in order to provide a unified financial system and help reintegrate the world cost-price structure—in short, what their contribution should be

toward restoring a world economy. These are the most pressing problems for the moment. But the suggestions presuppose that there is a stable monetary and trading area that they can adjust to. However, there is a question of how long the dollar standard will continue to give a stable basis on which to organize the world financial system. The maintenance of financial order will involve some important responsibilities on our part.

Some people seem to believe that the main work of providing a stable international monetary standard will devolve on the International Monetary Fund. In its future development they expect it to serve the international economy in a capacity somewhat similar to that in which a central bank serves a national economy. But I believe this is a mistake.

The original Keynes plan *did* offer this theoretical possibility. It provided for a kind of international central bank that would supposedly regulate the world reserve-money supply in the common interest, so that all countries could maintain reasonable stability—at least in normal circumstances—provided they were themselves willing to make the appropriate internal adjustments. (The plan had the fatal weakness of requiring unlimited acceptance by the United States of balances in the Clearing Union.)

But the present Monetary Fund is not an international monetary authority in any true sense. It does not determine the conditions of the supply of money but presupposes some kind of international money already in existence. It does not determine the principles for the management of the money to which the national units are attached, but concentrates on the problem of parities. It assumes that a serious disequilibrium in a country's international accounts will be dealt with by a change of parities; and its most important function is to police this process—to see that a change of parity is no greater than what is required to restore balance. (I am giving no attention to its lending activities, since these seem to be no more than a minor convenience and might better be handled through some American institution.)

Now one may doubt whether a system of independent currencies mutually adjusting to one another by changing exchange parities can take the place of an international standard. Under circumstances of the present the adjustment of parities should of course be stressed, since it would be fanciful to suggest returning to dollar parity by deflationary processes. But it is quite another matter to depend upon the adjustment of parities as a rather usual procedure for balancing the international accounts. While exchange adjustments are better than exchange controls, they nevertheless prevent a close integration of prices throughout the inter-

national economy. An adjustment which tends to cut all the price tags of a national economy at once may remove some price discrepancies, but at the same time it creates others. One cannot of course claim that a workable system requires that there be no shift in parities when the period of reconstruction is over, but it would not be desirable for the important national economies to resort to it.

However, if the maintenance of parity is to be the rule, there must be a central currency which is stable in value and it must be easily accessible to the member countries which stabilize with it and hold it as their international reserve.

Under the nineteenth century gold standard, sterling served in the capacity of a central currency. It had the great defect that it enforced great expansions and contractions of demand. It is true that the Bank of England did a great deal to neutralize the effect of gold movements; but when the gold reserve was dangerously low the managers of the standard—they would have denied that they were such—had no other alternative under the existing rules but to contract.

But sterling as the international currency had the great merit that it was accessible. Those who needed bills on London in order to meet their international obligations could always obtain them by selling goods to England. The terms might be hard but the goods could always be sold at some price or other, even during the worst depression, and without the payment of any duty; and the money received was good over the entire world. As Professor Clay has so aptly expressed it, England was the "buyer of last resort." England was also the "lender of last resort." Good bills drawn against exports to any part of the world could always be converted in the London money market into international cash.

When the United States took over the rôle of managing the international currency during the First World War, we were in one way better situated than England had been to discharge such responsibilities during the nineteenth century, but in some ways less well situated. We were in a better position in that we had greater freedom of action in the management of the dollar. We had little need to worry about the flight of gold in devising monetary policy; and at the present time we need have no fear at all; for the American economy is so strong and the prestige of the dollar is so great that its position would not be shaken if we were to slough off the remaining forms of the gold standard. Unfortunately, however, we did not use our advantage when the great test came in the early Thirties. While holding the largest gold reserve that had ever been gathered together we allowed our monetary system to go into ruinous contraction

and carried the other currencies with us until they cut loose from the dollar. It was here that we had a "dollar shortage" in the appropriate sense of the term. Dollars were not short then because there was inflation in the member countries, but because in the country which managed the world standard there was a drastic contraction of demand, while at the same time there was a high tariff wall to keep out foreign goods. The window where international cash might be obtained was closed.

So in one way we are less well situated than England was to manage the international monetary standard. We have no political ideology that allows us to be the buyer of last resort. We do not raise free competition to the level of a principle to which we remain steadfast even during depression. America has been liberal in making public loans and gifts to other countries, and in prosperity we are heavy importers, but in depression our imports are drastically diminished, and in a world where the dollar is international reserve this is nothing less than a calamity.

In another respect our position as manager of the international standard is more difficult than that of England used to be. On the whole the nineteenth-century world was prepared to make the sacrifices necessary in the lowering of costs to meet the conditions of the gold standard—sacrifices in the form of business losses, the increased burden of debts, and unemployment. These sacrifices were thought well worth making in order to avoid the dangers of a paper currency. The nineteenth century world had been taught to fear inflation as the greatest of economic evils. But the experiences of the Nineteen Thirties have conditioned the present world to fear unemployment as the greater evil and it is willing to throw in the balance the dangers of inflation and the machinery of a new mercantilism to attain that end. To manage an international standard so as to permit high employment, while at the same time the member countries maintain parities and forego the use of exchange controls, will be a difficult task indeed.

Yet, if international trade is to be organized on a price basis and if the standard of life is to be raised in other parts of the world, we must have such a standard. No other country besides the United States is in a position to assume the responsibility of providing one. Moreover, America has no national interest that would prevent her from trading with the utmost freedom with the rest of the world, from becoming the buyer of last resort. Nor do we have any need to resort to commercial restrictions or exchange rationing because we may lack the means of purchasing what we want from abroad, for the dollar is good money everywhere. Neither do we need to resort to exchange cutting in order to sell. For we may be

quite sure that other countries will buy from us to the extent that we make it possible for them to do so by providing dollars with our imports, saving only such dollars as they need for reserve. And above all, we do not have to make the difficult choice between a policy that will maintain internal stability and one dictated by the needs of maintaining exchange parity. If we do not maintain a high level of economic activity, and without inflation, we can have no one to blame but ourselves, or rather, those who conduct our policies. Furthermore, policies in the interest of our own economic stability are also in the interest of the rest of the world.

Formal international organization will not provide the necessary machinery for a stable monetary standard. Without international sovereignty the central money of the world must necessarily be managed by some one nation; and it will be adhered to by other nations because it is to their interest to do so. The responsibility is ours and we must assume it. There is no more likelihood that the world will have a stable financial organization without our assuming the responsibility of managing it than that the world can have political stability without our shouldering the main responsibility.

Yet one may not feel too confident that the world wants the return to a system of trading along the lines of price incentive, that is, along the lines of liberal capitalism. Production within national borders may be organized more and more along authoritarian lines and of course international exchange could scarcely then be organized in any other way than along political lines. But a world ordered in this way would not be a safe world for the smaller national economies, but would be one of economic vassalage. Whether it would be a safer world for the individual we do not know, but it is not likely that his standard of life would be as high.

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Planning Cities for People

WE LIVE IN A world of compensation, under laws that are universal, immutable, implacable, and yet beneficent; for without these eternal, immutable laws there would be no progress. If we build so that our building is on sand, the building falls and we learn a lesson. If we build the buildings in our city so that they destroy the health and the safety of our people, we shall learn our bitter lesson. If we plan our lives and our cities so that they shall be fit for the purpose for which they are planned, this immutable, implacable law will yield us all its beneficent fruits.

LAWSON PURDY