MEASURES FOR INTERNATIONAL ECONOMIC STABILITY

Report by a Group of Experts
appointed by the Secretary-General

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PREFACE

This report is related to, and in some respects supplements, two previous reports — *National and International Measures for Full Employment* (December 1949) and *Measures for the Economic Development of Under-Developed Countries* (May 1951)—prepared by other groups of experts whom I appointed at the invitation of the Economic and Social Council.

According to the first of these two reports, the object of a full employment policy in its international aspects is "to create conditions under which any particular country will so behave in its international economic relations as not to prevent other countries from maintaining the stability and prosperity of their economies". To the extent that national action alone cannot ensure this, it was recommended that concerted international measures should be taken. The report suggested measures for bringing about a new equilibrium in world trade, and for the stabilization of the flow of international trade as well as of international investment for economic development. It contained far-reaching proposals for extending the activities of the International Bank for Reconstruction and Development and of the International Monetary Fund. After considering these proposals at its eleventh session (August 1950), the Economic and Social Council in resolution 290 (XI) requested me to appoint a further group of experts to formulate and analyse "alternative practical ways" of dealing with the problem of reducing the international impact of recessions. The terms of reference of the experts are set forth in the supplement to the present document.

The special vulnerability of under-developed countries to economic fluctuations arising outside their borders has long been a matter of international concern. In *Measures for the Economic Development of Under-Developed Countries* this vulnerability is viewed as constituting a reason why these countries should hasten the pace of their economic development. In the present report, on the other hand, following the instructions of the Economic and Social Council in resolution 341 (XII), attention is given to concerted international action to reduce fluctuations in the volume of trade and in the prices of primary commodities, and thus to moderate the swings in the terms of trade of under-developed countries which accompany such movements. In addition, measures are suggested to enable under-developed countries to maintain their programmes of economic development at a reasonably steady rate in the face of such fluctuations as persist.

The authors of the present report stress that, in recommending policies which would help to improve international economic stability, they have been concerned to discuss the conditions under which such policies might be made practicable and effective. They point out that the instability of international economic relationships can be kept within manageable limits only if countries are prepared to play their part in establishing and participating in international arrangements in accordance with the principles discussed in this report.

It is with these considerations in mind that I commend the report to the attention of Member Governments, to which copies have been transmitted. The report represents the unanimous views of its authors, who acted in their personal capacities and whose recommendations are put forward on their own responsibility.

The group included James W. Angell, Professor of Economics and Executive Officer of the Department of Economics, Columbia University; G. D. A. MacDougall, Fellow of Nuffield College and Reader in International Economics, Oxford University; Javier Marquez, Alternate Executive Director, International Monetary Fund, formerly Professor of Economics, National School of Economics, Mexico; Hla Myint, Lecturer in Colonial Economics, Oxford University, formerly Professor of Economics, Rangoon University; and Trevor W. Swan, Professor of Economics, Australian National University.

On behalf of the United Nations, I wish to thank the experts for the contribution they have made to the solution of the problem of reducing the international impact of recessions and to the understanding of related questions of international economic stability.

Trygve Lie
Secretary-General

LETTER OF TRANSMITTAL TO THE SECRETARY-GENERAL

We have the honour to submit herewith our unanimous report, *Measures for International Economic Stability,* which we were invited to prepare in pursuance of Economic and Social Council resolution 290 (XI), paragraph 19, and resolution 341 (XII), paragraph 5.

In compliance with the first-mentioned resolution, we have consulted the International Monetary Fund and the International Bank for Reconstruction and Development. We have also taken into account the views expressed by members of the Council in the debate during its thirteenth session on matters relevant to our task, in accordance with Council resolution 367 B (XIII) of 13 August 1951.

Meetings were held at the Headquarters of the United Nations during seven weeks, from August to October 1951. At the request of the group, James W. Angell served as Chairman.

We wish to express our gratitude for the valuable assistance rendered by the Secretariat of the United Nations.

Respectfully yours,

James W. Angell

G. D. A. MacDougall

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Hla Myint

Trevor Swan

United Nations, New York
November 1951

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MEASURES FOR
INTERNATIONAL ECONOMIC STABILITY

Chapter I

ISSUES AND PRINCIPLES

1. It is now generally accepted that the major countries have both the will and the means to avoid deep and prolonged depressions. The full employment pledges embodied in the United Nations Charter, and in other national and international instruments, reflect the fact that in one decade the world has taken a long step forward in social attitudes and economic techniques. But we are still living in the shadow of the great depressions of the past. Full employment commitments cannot wipe out overnight the ingrained distrust of dependence upon a many-sided international system, and do not themselves create the complex institutional and economic framework which such a system requires for its working.

2. Nor is this distrust wholly groundless, since in the existing precarious state of the world's economic balance even minor disturbances in one part of the world—disturbances which may often be inseparable from economic progress itself—may give rise to major repercussions elsewhere. Until an economic mechanism has been found which will cushion the international impact of these disturbances, it is hard to envisage the restoration of a multilateral system of trading and investment which will help the resources of each region to play their most effective part in raising living standards everywhere.

3. It is this background which gives a wider significance to the limited and specific problems which we have been asked to consider. This report is a sequel to two earlier United Nations reports, *National and International Measures for Full Employment* (December 1949) and *Measures for the Economic Development of Under-Developed Countries* (May 1951). With their broad economic analysis we are in agreement. Our report is not concerned directly with the maintenance of full employment, the avoidance of inflation, the establishment of a new equilibrium in world trade and payments or the economic development of under-developed countries, which were principal themes of the previous reports. It is concerned rather with particular aspects, and especially international aspects, of all these themes. We have been asked, in substance:

(*a*) To formulate and analyse "alternative practical ways" of reducing the international impact of recessions that may arise in any part of the world; and

(*b*) In so doing to give particular attention to the problems of the under-developed countries, which are especially vulnerable to fluctuations in international commodity markets and to related fluctuations in the terms of trade.

Sources of international instability

4. If a future "recession" of the size and duration of that of the 1930's had to be contemplated, we would be unable to suggest measures which would make much difference to its international impact and which might at the same time be regarded as practicable or acceptable. We have assumed, however—and we believe this to be the realistic prospect—that every large industrial country will honestly and actively seek to keep unemployment within limits which are consistent with the national and international undertakings which it has given.

5. This assumption still leaves the way open for fluctuations whose international impact, although mild in comparison with some past experiences, may present other countries, that are also seeking to maintain full employment and economic stability, with very serious problems. In the first place, "full employment" is a matter of degree; allowing for frictional and seasonal unemployment, a country which puts a good deal of emphasis on the desirability of elasticity in its economic system may quite reasonably consider that a range of unemployment varying between 2 per cent and 5 per cent, for instance, is a legitimate margin of tolerance. In the second place, a country may find that its institutional arrangements and policies are not capable in practice of preventing unemployment from going beyond such a margin for occasional short periods, until there is time for remedial measures to be introduced and to take effect.

6. Between 1920 and 1921, total employment in the United States declined by 9 per cent; between 1937 and 1938, by 4 per cent. In at least the second of these instances the decline was from an absolute level which could scarcely have been regarded as consistent with present full employment obligations, and in neither were remedial measures taken as promptly or effectively as would presumably now be the case. We should expect that in the future any such declines in employment would be reversed in the following year or so; but whether we like it or not we must realistically face the prospect that year-to-year fluctuations in employment in the United States can still occur on the scale of 1937 and 1938, if not of 1920 and 1921.

7. The immediate implication of this prospect for the rest of the world can be seen from the fact that between 1937 and 1938 United States merchandise imports dropped in annual dollar value by 36 per cent, and between 1920 and 1921 by 52 per cent. A future recession might continue for more than one year, although we should not expect it to continue for much more than two, before recovery was complete. Allowing for payments for services as well, the total resulting loss of dollar receipts by other countries, at the present level of United States imports, might well approach $10,000 million[1] over the whole period of recession and recovery.

[1]This estimate is discussed in paragraph 115, below, and is explained in the annex

8. The magnified movement of payments for imports reflects partly a tendency for the actual consumption of some imports to vary more than proportionally with employment; partly the accumulation and liquidation of inventories; and partly a simultaneous fluctuation in the prices of the goods traded (especially the prices of primary products). In fact, it is quite possible for cycles in the movement of inventories, and associated speculative price movements, to produce large changes in the value of imports without any significant fluctuation in the level of employment—as was seen in the course of 1949. For particular commodities and particular countries the impact may, of course, be much more serious than any consideration of aggregate fluctuations would suggest.

9. Along with fluctuations in net payments for goods and services, there will often be fluctuations in net payments on capital account in the same direction. These may take the form of short-term capital movements or of the drying up of a stream of long-term international investment. Even with strict exchange controls, within a few months the effect on the balance of payments can amount to the value of two or three months' trade.

10. In other words, the new era of "full employment" does not provide any clear assurance against fluctuations whose year-to-year international impact may be of the same order as those experienced by the trading partners of the United States in 1937 and 1938. With merely a brief human failing in the carrying out of an otherwise successful policy of full employment, and perhaps without any serious fluctuation in employment at all, the rest of the world may for a year or two at a time lose many thousands of millions of dollars in sales and payments on current and capital account. Countries seeking both to maintain internal economic stability and full employment, and to preserve a reasonable balance in their external accounts, must reckon with this fact. The establishment of full employment as a firm objective of policy in all countries does, however, guarantee that these losses will not be more or less indefinitely prolonged. We believe that in the future, "prosperous" years will be the rule rather than the exception, and even in years of recession prosperity will be, not merely around the corner, but in full view. This for the first time makes the problem of international economic instability a manageable one.

11. Not all the problems of international instability arise from broad fluctuations in economic aggregates. It is necessary, for example, to reckon with crop fluctuations and other irregular movements in the supply of, or the demand for, particular commodities, and with associated price fluctuations which may often be violent. Acute problems may also emerge as the result of permanent changes in the structure of demand or supply, such as the development of a cheaper substitute for an important commodity. We have not, in general, considered it within the scope of this report to examine these instabilities directly, but have tried to allow for their presence wherever this seemed relevant to the question at issue.

12. We have chosen the United States for our illustrations, although similar examples might have been given of the effects of past fluctuations in other industrial countries. This was a deliberate choice, since we believe that in future the real danger to the economic stability of the rest of the world lies in recessions originating in the United States: partly because of the dominant position of the United States in international trade and payments, and partly because of the institutional and economic factors which make the United States economy more liable to internal fluctuations in effective demand than are the economies of other important trading nations. It is not necessary to spell out these reasons, since most of our analysis and conclusions would stand even if there were a serious risk of fluctuations originating in, for instance, the United Kingdom. The main point is that a workable international economic system must in any case provide an insurance against fluctuations in the United States. If it can successfully cope with these, then only a relatively small margin need be allowed for the risk of independent fluctuations elsewhere.

Current problems and prospects

13. Today's problem is certainly not one of recession. The immediate economic problems arise chiefly out of the vast rearmament programmes being undertaken in the United States and elsewhere. In many countries prices are rising, and in some there are fears of cumulative inflation. In certain European industrial countries, the improvement in the dollar position between 1949 and 1950/51 has been succeeded by renewed balance of payments difficulties resulting from the diversion of their resources into defence activities and the worsening of their terms of trade. Some raw materials are in such short supply that international efforts are being made to regulate their allocation. The under-developed countries and other exporters of primary products have experienced considerable—although very irregular and unevenly distributed—increases in export prices, but are afraid that the opportunity to import goods for developmental purposes which is given by their improved terms of trade will be lost as a result of physical shortages of capital equipment.

14. Some of these problems—in particular those involving the financing of rearmament by measures which will withdraw the necessary resources from civilian uses without inflationary pressure—are matters of internal national policy with which this report is not directly concerned. Many of the others ultimately resolve themselves into questions of international equity in the sharing of the direct and indirect costs of rearmament; these questions require consideration essentially at the political level.

15. The change in the terms of trade between primary products and manufactures is, however, more intimately related to the subject-matter of this report. It should not be thought that the increases over the past two years in the relative prices of primary products have been simply the result of ephemeral factors, such as "inflationary gaps", speculation or defence

stockpiling. During this period (mid-1949 to mid-1951) the aggregate gross national output of North America and western Europe has probably risen in real terms by as much as 15 per cent, and its industrial component a good deal more. The intensified demand for raw materials and foodstuffs resulting from this general increase in the production of goods and services, with the real purchasing power it represents, has in most cases been met only to a very small extent by larger supplies of primary products. Since the price elasticity of demand for primary products is usually low, the relative increase in demand over supply has had to be choked off by an even greater rise in the prices of primary products relative to the prices of other goods and services. The consequent broad movement of the terms of trade should therefore be regarded in considerable measure as the reflection of *real* movements in employment and productivity, although in the short run and in the markets for individual products more ephemeral factors have often been important.

16. In turn, the current inflationary process in industrial costs and prices appears in many cases to be largely a vain attempt on the part of industrial communities to escape the effects of this shift in price relationships on living standards, by forcing up their money wages and other money incomes—an attempt which, in the trading world as a whole, sooner or later drives the money prices of raw materials and foodstuffs still higher. Traditional methods of fighting inflation by general financial or monetary measures may not succeed in halting this type of spiral, unless they are pressed so far that they also restrict the level of industrial output and employment.

17. Beyond the present problems of inflation and shortage lies the possibility of a post-rearmament recession, particularly in the United States. No one can say how long the rearmament programme will continue, or how it may expand or contract. It may prove possible to compensate for changes in defence production by changes in civilian production, so that the total output maintains an even trend. But any substantial or sudden cutback in rearmament would clearly involve a serious risk of recession, and even a levelling off of the programme would mean a drop in the secondary defence demands for inventories, plant and equipment. The timing of a recession is likely to be closely affected by the extent to which, in the course of rearmament, backlogs of demand for civilian investment and consumers' durable goods may be built up, as they were during the Second World War.

18. We cannot predict in what manner a recession may arise, how large it may be, or when it may occur. But to consider and provide against its impact in advance is a small insurance premium to pay in comparison with the national and international interests which are in jeopardy.

Proposals of report on measures for full employment

19. The authors of *National and International Measures for Full Employment* offer two major proposals as a protection for countries seeking to maintain their economic stability in the face of a recession originating outside their borders:

(*a*) They recommend a scheme under which countries experiencing a fall in their exports, as the result of a decline in effective demand in another country, would in general be entitled to obtain a special supplement of foreign exchange, sufficient to make good the deficit on current account which would emerge if they continued to purchase the same volume of imports from the other country as in a "reference year", which would normally be the preceding year. In effect, the latter country would be required to replenish the foreign exchange reserves of the deficit countries by lending back to them, through a separate account in the International Monetary Fund, any increase in its own foreign exchange reserves resulting from a decline in its imports identified with a recession in its effective demand. This loan, or "deposit", would be repayable only if in a subsequent period its reserves were to diminish, and those of other countries to increase.

(*b*) They recommend a scheme under which countries undertaking long-term investment abroad should fix for five years ahead the annual total of their lending on both public and private account, and should make good through a separate account in the International Bank for Reconstruction and Development any deficiency in the actual flow of their long-term investment through other channels below the total fixed.

20. Subject to certain important technical and practical qualifications, the upshot of these proposals would be to ensure the availability of a steady flow of foreign exchange on current account and on long-term capital account, the former being protected by supplementary "deposits" against recessions of effective demand that would bring the inflow of exchange below its previous annual peak, and the latter against fluctuations within five-year periods.

21. We are convinced that some new international provisions working in this direction are essential. Present reserves of gold and dollars in most countries, together with such supplements as are in sight within the present resources, quota provisions and policies of the International Monetary Fund, are quite inadequate to support any serious drop in dollar exchange receipts. A recession in the United States would in existing circumstances almost certainly lead to a fresh outbreak of restrictions and discrimination in international trade, reversing the progress which has been made in recent years towards convertibility and multilateralism; it would seriously impair the ability of the under-developed countries to spend dollars for their own development; and it might compel some countries to restrict imports even of raw materials below the levels necessary to keep their industries and

workers fully employed. To remove these dangers would be an enormous advance in the machinery of international economic relations.

22. Assuming a recession in the United States, the measures proposed in *National and International Measures for Full Employment* would, in general, give other countries the opportunity to maintain their employment and incomes, and their imports from the United States, without running down their reserves of gold and dollars. But to make use of this opportunity, industrial countries would have to be ready to take internal measures to compensate for the decline in employment in their export industries, including any secondary decline which might result from the failure or inability of some other country to maintain its own income and demand for imports. Countries exporting primary products would not be so liable to actual unemployment in the conventional sense, but would have to be ready to stabilize their incomes and development programmes in the face of a decline in their export prices. In seeking to do this, they would have to deal with the fact that their export prices and foreign exchange receipts had fallen, not merely in direct trade with the United States, but also over a wide range of trade with other industrial countries, even where the latter had successfully maintained their own employment and incomes. For these secondary losses the proposals referred to would provide no compensation.

Instability of prices and terms of trade for primary products

23. This additional problem of the primary exporting countries arises from the fact that, whereas industrial resources used in production for export can usually be re-employed for other purposes, the resources in agriculture and some other primary industries are more immobile in the short run, and often go on producing the same types and even quantities of output as before, while—because of demand inelasticities—the prices received fall proportionately much more than the volume of sales.

24. The *indirect* effects of fluctuations in effective demand in a major industrial country, even assuming that other industrial countries successfully compensate for the loss of employment in their export industries, are therefore twofold:

(*a*) There is a swing in the terms of trade between primary and manufacturing industries, with consequent instability in the real incomes of both primary exporting and industrial countries, in the flow of foreign exchange between them and in the opportunities for capital development, particularly in under-developed countries.

(*b*) Since the movement of the terms of trade normally takes the form of a wide movement of primary product prices, accompanied by a smaller movement of industrial prices in the same direction, there is even greater instability of money prices in both primary exporting and industrial countries. In a recession this aggravates the problems of maintaining stable effective demand, and in the opposite case it produces inflationary problems. If, as is likely, industrial money wages and other industrial incomes fall very little when primary product prices fall, but are forced quickly upwards when those prices rise, then the result will be not merely price instability, but a long-run tendency towards the inflation of money prices and money wages throughout the trading world.

25. Neither of these indirect effects can be overcome by the mere assurance that a country in which a recession originates will maintain its flow of foreign exchange to the rest of the world, although to the extent that the maintenance of this flow promotes stability of employment and incomes elsewhere, the magnitude of the effects will be reduced.

An alternative approach

26. In any event, it seems from the debates in the Economic and Social Council that the particular measures suggested in *National and International Measures for Full Employment* as a means of maintaining this flow of foreign exchange did not commend themselves to governments as acceptable or practical. We have studied the debates, and have considered alternative methods of approach, which are analysed in later chapters of this report.

27. We have been concerned to suggest policies which would help to improve international economic stability, and to discuss the conditions under which such policies might be made practicable and effective, rather than to draw up blueprints for rigid and automatic stabilization devices. The simplicity of such devices is often more apparent than real; and no set of fixed rules can successfully replace the exercise of responsibility and discretion by the appropriate national and international institutions. We have also tried to rely as far as possible on the use of existing international agencies, and to point to what it may be possible to achieve with their present constitutions and resources, as well as to indicate the directions and circumstances in which these may need to be altered.

28. It follows that we think it would not be useful to present any catalogue of recommendations to which effect might apparently be given by the stroke of a pen. The main lines of our alternative approach are briefly indicated in the following paragraphs.

(i) *International commodity arrangements*

29. We know of no practicable method of reducing the international impact of short-run fluctuations in the prices and terms of trade of primary products, other than a direct and detailed attack on the problem through the negotiation of international commodity agreements. From the present point of view the essential objective should be, not the introduction of restrictions to help remove "burdensome surpluses", but the stabilization of world commodity markets in the face of the temporary ups and downs of demand and supply. For this purpose, many different arrangements may be suitable for different types of commodities, including long-term contracts, multilateral quota systems of the Wheat Agreement type, and buffer stocks, either alone or in combination.

30. Governments should reconsider the case for a series of commodity arrangements from this point of view. Both exporting and importing countries concerned should participate in each agreement, and we have suggested that the International Bank for Reconstruction and Development might indicate that it is willing in principle to consider assisting in the financing of buffer stocks, as a means of promoting satisfactory conditions for economic development. We hope that the current discussions of the international allocation of scarce materials will be accepted as an opportunity for introducing permanent stabilization schemes for a number of commodities.

(ii) *The international flow of capital*

31. Rigid stabilization of the total flow of long-term capital from each country does not seem practicable or even necessarily desirable. On the other hand, it is important that countries should be able to maintain steady development programmes, and this objective cannot be considered separately from fluctuations in international receipts and payments on current account. We have suggested that the International Bank for Reconstruction and Development should be prepared, in the event of recession, to expand greatly the flow of its lending. In this way, it may help in part to offset fluctuations in private international investment but—more important—it may prevent the sharp setback to development, especially in the under-developed countries, which would otherwise be caused by a drop in export proceeds. The total foreign debt burden assumed by any country over a period of years should not, of course, go beyond some limit which must be determined with regard to the stage of its development and its economic prospects. But within this limit countries should be able to rely on a larger flow of capital from the Bank in bad times than in good.

32. If the Bank is to be ready to play its part in the event of a recession, both in long-term investment and in the financing of buffer stocks, it may need to have access to a more flexible source of funds than is at present provided by the sale of its securities on the market. We have suggested that consideration be given to increasing the proportion of the Bank's capital which is actually available for making loans, increasing the total capital itself, and setting up arrangements under which governments or central banks could purchase the Bank's securities if the need arose.

(iii) *International monetary reserves*

33. One of the agreed purposes of the International Monetary Fund is "to give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balances of payments without resorting to measures destructive of national or international prosperity". We believe that the Fund is a workable instrument which can go a long way towards fulfilling this purpose. In recent years few countries have had *temporary* balance of payments difficulties which would justify access to the Fund's

resources. In the event of a recession, however, the Fund should be prepared to waive freely the rule which limits annual drawings to 25 per cent of a member's quota. It should offer promptly to help overcome the temporary difficulties of its members, even though their practices might normally be regarded as out of keeping with its long-run objectives, where refusal of drawings would force tighter import restrictions or unemployment and so defeat the Fund's purposes. If the Fund has any doubt whether a member's need of assistance will be temporary, it should give the member the benefit of the doubt, while at the same time reinforcing the repurchase provisions of its Articles of Agreement by asking for more specific commitments to repurchase over an agreed period.

34. Although with its existing resources the Fund may be able to cope with minor fluctuations, a major recession—for example, one approaching the severity of the United States recession in 1937 and 1938—would quickly exhaust the Fund's present holdings of gold and dollars. For this reason, there is a case for increasing the total of the Fund's subscriptions, the real value of which has been greatly diminished by the rise in prices since the Fund was set up. The practical difficulties in the way of securing a prompt and sufficient increase in the Fund's resources by this means, however, may make it necessary to rely on the Fund's borrowing from the country experiencing the major recession. That country might well take a liberal view of lending its currency to the Fund as a means of preventing unemployment in its export industries, of reducing the need for other countries to take new discriminatory measures against its exports, and of giving effect to the spirit of its international full employment commitments.

Limitations of this approach

35. It is evident that action along these lines will leave many problems of international economic instability to be dealt with by individual countries as best they can.

36. International commodity agreements are notoriously difficult to organize and to operate, and the range of products which they can be expected to cover is necessarily limited. How far the International Bank for Reconstruction and Development may be able to expand its lending in the event of a recession depends entirely on its success in finding credit-worthy borrowers and on the practicability of its gaining access to a more flexible source of funds. The proposed use of the resources of the International Monetary Fund—unlike the scheme recommended in *National and International Measures for Full Employment* — is basically the equivalent of a once-for-all increase in its members' foreign exchange reserves, which can do no more than enable them to smooth out temporary fluctuations in the availability of foreign exchange. It cannot repeatedly make good the full losses of recession years, and so will not permit any country's payments for imports to exceed in the long run its actual exchange

earnings on current and capital account—although how long this run may be will depend to some extent on the terms on which a country suffering a major recession may be prepared to lend its currency to the Fund.

37. Nothing in the approach we have suggested will relieve any country of the responsibility of limiting its demands for consumption and investment to the total of the resources available to it, if it is to avoid inflationary pressure. Each country, even on the most hopeful view, will still have to deal with the domestic impact of important fluctuations in international demand and prices, which it will have to offset if it wishes to maintain a reasonable degree of internal stability. The steps to be taken for this purpose involve many problems of policy and administration—including problems of fiscal and monetary policy, export and import taxes and subsidies, marketing schemes and exchange rates—into which it is not our province to enter.

38. Nevertheless, we are confident that even modest progress in the directions we have indicated will make an important contribution to stability. For most countries, the remaining problems can then be made manageable, and major crises of the international economy can be avoided.

Special problems of under-developed countries

39. On the other hand, even taking the most hopeful view, we fear that action along these lines will not meet the special difficulties of the poorer under-developed countries. They will share with other countries in any general improvement of international economic stability. But it must be remembered that many under-developed countries are dependent on a very limited range of exports, which in some cases may be left largely uncovered by such commodity arrangements as it is possible to negotiate. At the same time, their margin of consumption above subsistence requirements is very small, and the main brunt of any drop in their export receipts must therefore be borne by their development programmes, which are vital to their future. Further, their ability to cope with a recession is in many instances limited by the absence of proper institutions and experience in the field of fiscal and monetary policy and in other aspects of internal stabilization.

40. There is a danger that some under-developed countries, which have to look to the International Monetary Fund and the International Bank for Reconstruction and Development to help them out of these difficulties, may fall between two stools. On a very short-run view, in time of recession the uncertainties of the returns from the export of particular commodities may cast doubt on the prospects for early repayment, while a very long-run view of development may not give sufficient attention to the pressing needs of the moment. This danger underlines the need that the Bank be ready to increase its rate of lending in the event of a recession, so that the development being supported by export receipts and domestic savings will not be sharply interrupted.

41. Basically, the vulnerability of the under-developed countries to international disturbances is simply another facet of their general problem of under-development. In the long run, the process of development itself will make them less vulnerable by diversifying their economies and raising their living standards. There are no short cuts in this process. Even so, the development of the poorer countries will be intolerably slow unless a much larger flow of external capital is provided than at present seems to be in sight. The problem of supplying this capital is not directly our concern; it was considered at length in *Measures for the Economic Development of Under-Developed Countries.* A strong case can be made for loans to some of the under-developed countries on especially easy terms or for outright grants, particularly in the event of a major recession—but these are not issues which we are called on to examine.

The establishment of appropriate price relationships

42. However, our terms of reference do expressly require us to consider, as part of the problem of reducing the vulnerability of under-developed economies to fluctuations in international markets, "measures to adjust, establish and maintain appropriate relations between prices of raw materials, on the one hand, and essential manufactured goods on the other, and thus to ensure greater economic stability".

43. The approach we have already outlined would go some distance towards achieving this objective, both directly in terms of commodity agreements and indirectly through the stabilizing influence on the terms of trade of a greater measure of stability in international effective demand as a whole. But these effects are essentially no more than a matter of smoothing out the sharp short-run fluctuations; the stabilization achieved could not be complete, even in the short run, and the longer-run trends or fluctuations would be left substantially untouched.

44. We have considered the possibility of a more far-reaching and literal interpretation of this clause of our terms of reference—for instance, reading it as an invitation to propose some kind of systematic international "parity price" scheme for raw materials or other primary products. We believe that no such scheme would be either practicable or desirable. Although some short-run stabilization of prices can be achieved by buffer stocks and similar measures, in the long run the artificial maintenance of any particular set of price relationships necessarily implies the permanent operation of international controls over the production or the allocation of the commodities concerned—in other words, a controlled world economy for primary products, including such measures as acreage allotments for each agricultural commodity in each country. In any case, if the objective were to help the under-developed countries, artificial support provided by "parity prices" would be, in general, an extremely wasteful and inefficient method. The main beneficiaries would be the producers in the richer and often highly industrialized countries, who furnish the greater part of the world's commercial supplies of most primary products (including indus-

trial substitutes for such products). It should also not be forgotten that the under-developed countries are themselves large consumers of imported primary products, and that in general price relationships amongst the different primary products are just as important as those between primary products and other goods and services.

45. This does not mean that whatever trend of price relationships may emerge from the play of economic forces is, in some sense, necessarily "appropriate". The "invisible hand" of the price mechanism may not always ensure an ideal distribution of either resources or incomes. But we can see no prospect that a system of direct international intervention to fix long-run price relationships would achieve results nearer the ideal, even assuming that such an ideal could be internationally defined.

46. Furthermore, it would certainly be wrong to think that the supposedly unfavourable trend of the prices of primary products relative to manufactures in the half century ending in the 1930's leads to any presumption that the trend in the next half century will be in the same direction. Given a substantial measure of full employment in industry, the drift of labour out of agriculture in industrialized countries is likely to be accelerated, while demand may grow faster as the result of the greater economic progress made possible by the more continuous use of available resources. The scope for an extension of primary production in new areas of settlement seems now to be comparatively limited, and in existing areas the application of more resources to the fixed supply of land meets with diminishing returns. But the possibilities of synthetic or other industrial substitutes for a number of primary products are increasing, and there is very great scope for improved agricultural productivity together with industrialization in many under-developed countries. To predict the outcome of these and other factors over a number of decades would be to write history in advance.

47. In the long run, the major disparities in income and living standards between different countries can be accounted for by disparities in the availability per person of capital equipment, natural resources and skills. These disparities can be reduced only by the process of development itself. The pursuit of higher standards of productivity is likely to be more rewarding than a concentration upon restrictive policies designed to improve the position of one group at the expense of another, whether on the part of primary or of industrial producers.

48. On the other hand, every country in framing its developmental policies must form some judgment of the future long-run relationships among different prices, in order to guide its resources of labour and capital into the avenues which will yield the greatest returns. For under-developed countries, engaged in far-reaching structural changes within their economies, this judgment may be a very difficult one. There is some evidence that in the past many forms of primary production have from time to time responded too slowly, in the first instance, to increasing demand; prices

have gone to excessive heights, and new production (including production in industrialized countries) has been called forth on such a scale as to lead eventually to ruinously low prices, with many high-cost producers protected by subsidies or tariffs; and then, after a period of stagnation, the same cycle has perhaps begun again.

49. The smoothing out of the short-run fluctuations resulting from fluctuations in industrial demand should do something to make it easier to reach correct judgments about longer-run price relationships, and so to reduce these longer-run structural instabilities. But the remaining uncertainties will always be very great, and it is only to be expected that from time to time major errors of judgment will lead important industries, and perhaps whole countries, into serious difficulties.

Conclusions

50. The greater part of this introductory chapter has been devoted to explaining difficulties for which we can find no ready solution. We have outlined measures in the fields of commodity arrangements, international investment and foreign exchange reserves which we think would help all countries to manage their affairs more successfully as members of a stable and expanding world economy. But the measures are not of a kind which can be expressed in any definitive formula. They can be put into effect only through the vigorous pursuit by national governments and international agencies of policies which, in application, will require fresh judgments of facts and alternatives at every turn. No practicable action along these lines can provide a guarantee to any country against occasional abrupt disturbances in its dealings with other countries, and success or failure in coping with these disturbances must remain very largely the individual and collective responsibility of governments, as they take decisions in contingencies which cannot now be foreseen.

51. We believe that these difficulties and limitations are inherent in the problem presented to us. To suggest new or simple devices to overcome them might be to restate the problem in different words rather than to solve it: as if to say, for instance, that many of the world's troubles would be eased if one country would assume unilaterally the burden of international stabilization and meet the costs as they arise. This does not mean that the problem is, in a practical sense, insoluble. It does mean that the instabilities of international economic relationships can be kept within manageable limits only if most countries are prepared to play their several parts in setting up and working the necessary machinery, in accordance with principles which on the whole are already familiar. In this task the leadership and strength of the great industrial countries, and especially of the United States, are essential to success.

Chapter II

INTERNATIONAL COMMODITY ARRANGEMENTS

Instability of commodity markets

52. The exports of the under-developed countries and of certain others consist almost wholly of primary products. These are the main imports of the major industrial countries, and for various reasons their value fluctuates widely. First, the desire to keep working stocks of materials in a fixed relation to production commonly leads to larger proportionate variations in demand than in consumption. Second, speculative changes in inventories often aggravate rather than dampen more normal fluctuations in demand. Third, in countries which produce a substantial proportion of their own requirements of many basic products and import only their marginal needs, the demand for imports may vary much more than the total demand for the commodity. Fourth, changes in the demand for imported materials usually lead to substantial changes in their price. During the past few years alone many important commodities, including cocoa, copper, copra, cotton, jute, lead, rubber, tin, wool and zinc, have experienced both a price fall of over one-third and a price rise of over one-half. For some commodities, the price variations have been much greater.

53. Small fluctuations in production and employment in the main industrial countries can thus cause large fluctuations in the export proceeds of primary producing countries, quite apart from fluctuations caused by crop variations. Since the prices of manufactured goods tend to be relatively stable, it becomes difficult to plan and maintain steady programmes of economic development based partly on imported equipment. In addition, investment in primary production is likely to proceed by fits and starts, according to the state of the markets. There are likely to be recurring exchange crises and import restrictions that have repercussions throughout the world. The large variations in producers' incomes cause hardship and uncertainty, and inflationary and deflationary difficulties. All these problems are particularly serious for countries that depend chiefly on one or a few primary products for their exports.

54. The problems raised for manufacturing countries are also serious. Violent changes in the prices of raw materials and foodstuffs make it difficult to maintain internal financial stability. They can also affect foreign trade adversely. The rise in import prices during 1950 and 1951 had a serious effect on the balances of payments of the United Kingdom and of other industrial countries. In the past, severe falls in the export proceeds of primary producers have greatly reduced their demand for

the exports of industrial countries, and have led to unemployment in the export industries of these countries.

55. Fluctuations also increase the cost of primary products to manufacturing countries over a period of years. Compensation has to be paid to those who bear the risk, and variations in demand, especially for minerals, require the installation and maintenance of capacity sufficient to meet the peak demand; a steadier output would reduce the capital charges.

56. At a time when industrial countries are anxious to avoid future shortages of basic products, there are obvious disadvantages to them in fluctuating commodity markets which discourage investment in primary production and result in loss of output, particularly of minerals, in periods of temporarily low demand. The guarantee of a steady market would encourage expansion and ensure that output of scarce materials is maintained and stored rather than lost, should demand temporarily fall off.

57. Fluctuations in the demand for, and prices of, primary products thus raise many problems for both primary producing and industrial countries. They also aggravate the general problem of achieving and maintaining a steady and easy balance between the various parts of the world, without which it will never be possible to restore a multilateral system of trade and payments. A large part of United States imports consists of primary products and, so long as the dollar proceeds are subject to wide fluctuations, any balance between the United States and the rest of the world can at best be precarious.

58. Nor do violent fluctuations in the commodity markets perform any useful function. Price changes are certainly necessary to balance supply with demand by encouraging or discouraging consumption or production. Too rigid stabilization of prices would prevent economy in use and the stimulation of output in times of shortage, and the stimulation of demand and contraction of output when there is a surplus. But it is hard to believe that to achieve these objects, price fluctuations need be nearly so great as they are in fact. Much smaller changes would, on the contrary, obviate unnecessary and wasteful fluctuations in investment in primary production and in the use of primary products. There can be little doubt that they would, on balance, be better for all concerned.

Why the time is ripe for special measures

59. A necessary condition of reasonable stability in the demand for primary products is the avoidance of fluctuations in economic activity in the manufacturing countries. We assume that this will be achieved to a large extent and that serious depressions will be avoided. But we have seen that even quite small industrial fluctuations, which we cannot assume will be avoided, can have greatly magnified repercussions on the primary producing sector of the world economy. Special commodity arrangements are required to help combat these remaining fluctuations.

60. We recognize that international commodity arrangements of numerous kinds have been advocated for many years and that the record of achievement is small. Nevertheless, we feel that the time is now ripe for a new attempt, and this for two main reasons.

61. The first is that the essential condition of success is now, we believe, satisfied for the first time. We believe it to be a reasonable assumption that large-scale world depression will be avoided, and that, for the foreseeable future, there will be an upward movement in production of all kinds throughout the world, interrupted only by relatively minor setbacks. While prediction is dangerous, we also believe that the long-term trend of prices in general is more likely to be upward than downward, and that in any case disastrous price falls like the one in the early 1930's will be avoided. If, as we believe, these views are generally held, one of the main obstacles to commodity arrangements has been overcome. So long as there is widespread fear of major depression—and this fear was still common in the early post-war years—importing countries are naturally unwilling to make commitments through long-term contracts, through buffer stock schemes, or in any other way, to buy specified minimum quantities or to pay specified minimum prices for any appreciable period ahead; and without the co-operation of importing countries, primary producing countries, save those that are also major industrial producers, have not generally the resources themselves to undertake more than modest schemes.

62. But if a general long-term expansion in the demand for primary products is expected, it is in the interest of all concerned to ensure that the expansion is steady. The interest of exporting countries in avoiding fluctuations is clear and, if prices are in any case more likely to rise than to fall, importing countries need have less fear that commodity stabilization agreements will unduly raise prices against them. There is less danger that national or international authorities will buy up at great cost huge stocks that later have to be sold at a loss, with, incidentally, a destabilizing rather than a stabilizing effect on the market. Purchases for stock are more likely to prove a profitable investment. If the danger of shortage is likely to be greater than that of surplus, importing countries have much to gain by giving primary producers guarantees that will help to expand production. We are encouraged in our belief that some of these views are becoming more widely held by recent statements of responsible political leaders in the two largest importing countries. Finally, any schemes under which industrial countries continue to buy steadily from under-developed countries at times when private demand declines temporarily are much more satisfactory for both parties than financial grants or loans which might otherwise be thought necessary to avoid a breakdown. The importing country gets goods for its money, goods that will soon be used, not merely goodwill. The exporter continues to earn his living and avoids the burden of debt or the indignity of a dole.

63. The growing belief in the likelihood of an expanding world economy thus seems to us to remove one fundamental obstacle to commodity agreements. As recently as 1948, when the Havana Charter was drafted, such agreements were considered almost wholly in the context of burdensome surpluses. They can now be viewed in quite a different light.

64. A second major obstacle to commodity arrangements has been their complexity and the difficulty of reaching agreement on the innumerable detailed problems that arise, especially those relating to prices and quantities and provisions for their variation in the future. We by no means underestimate these difficulties. Arrangements will inevitably take a long time to negotiate. But we are encouraged by the fact that in the post-war years a number of agreements aiming at greater stability have been reached, in particular the International Wheat Agreement and the United Kingdom long-term contracts. The operation of these schemes may have raised difficult problems, but at least they have not broken down.

65. For all these reasons, we feel that the time is now ripe for a new, concerted attempt to achieve greater stability in the field of primary products, and that there are firmer grounds than existed in the past for hoping for success.

Types of commodity arrangements

66. We do not propose to analyse in any detail the various possible types of commodity arrangements. The details would have to be worked out separately for each commodity by those with expert knowledge of them and by those with power to negotiate on behalf of their governments. We shall confine this part of our report to a brief description of some of the main types of arrangements possible, together with some suggestions for general principles that might be followed.

67. We are concerned mostly with international measures, although where independent action can be taken by single governments the same general principles are usually applicable. Wherever possible, governments should not take action that will affect international commodity markets without consultation with the other governments mainly concerned. The scope for such independent action by exporting countries is limited in the case of most commodities, since these countries are generally unable to influence the world market greatly. The major importers, especially the United States and the United Kingdom, can significantly influence the market for a considerable number of commodities, but even for them certain types of action are of limited use. Where, for example, a major importing country fixes a maximum import price, this may greatly restrict sales of the commodity to it and so lead to unsatisfied demand.

68. Both importing and exporting countries, acting independently, can do much to insulate their economies from fluctuations in world markets through marketing boards, varying taxes or subsidies, and similar measures designed to stabilize internal prices or incomes. It is true that when the

world price rises, it may prove difficult for governments of exporting countries to resist producers' demands for higher internal prices, and general demands to spend the profits of marketing boards or the proceeds of export taxes. In importing countries, there is danger in increasing subsidies at times of rising import prices, since the subsidies may prove difficult to remove. Despite these difficulties, we believe that there is considerable scope for national policies of this type, but we are concerned in this chapter mainly with international action that will reduce the need for such policies by reducing fluctuations in world markets.

69. The main types of possible arrangements are: (*a*) long-term agreements on quantity and price, either bilateral or multilateral; (*b*) the allocation of maximum production or export quotas to exporting countries; (*c*) the allocation of maximum import quotas to importing countries; (*d*) the fixing of minimum or maximum prices; (*e*) buffer stock schemes. A variety of arrangements will be necessary, and for some commodities a combination of various types of schemes may be found most appropriate.

70. A fundamental principle of all schemes should be that, save in exceptional cases, they do not attempt to make the average price over a period of years higher or lower than it would otherwise have been. Their objective should be merely to reduce fluctuations around the long-term trend. This is a reason why present emergency import allocation schemes, which help to prevent excessive prices, should be supplemented by some guarantee by importing countries of minimum prices in the future. For the same reason, schemes should be avoided which involve action only by exporting governments acting together or by importing governments acting together.

71. Provided fair representation is accorded to both sides, we do not wish to rule out any particular type of agreement. We believe, however, that the allocation of maximum production quotas should be avoided so far as possible. These tend to freeze the geographical pattern of production and may lead to unnecessary unemployment of resources; where practicable it is better to stockpile a commodity in times of reduced demand than to limit its production. (There is no objection to the allocation of maximum *export* quotas provided output is not restricted and any excess is temporarily stockpiled.) Only where surpluses cannot be dealt with by stockpiling, and where the working of the price mechanism would restore a balance between supply and demand only painfully and slowly, should restriction of output be considered. In an expanding world economy, restriction of output is likely to be both unnecessary and undesirable for most commodities. Likewise, restriction of consumption by the allocation of import quotas should be avoided except in cases of international emergency.

72. Long-term agreements on prices and quantities may be bilateral or multilateral. The bilateral type may sometimes be convenient and desirable—for example, where one country takes a high proportion of world exports

of a commodity and where exporting countries do not feel the need for concerted negotiation with the importing country to avoid "exploitation". Since contracts with the various suppliers will be made at different times, it is probable that, at any one time, different prices will be paid to each, but the agreements need not for this reason be regarded as discriminatory, provided one supplier is not consistently favoured over another.

73. The International Wheat Agreement is an important example of a multilateral long-term agreement on prices and quantities. There is no need to describe it in detail. The fact that it has worked is a strong argument in favour of this type of scheme, and we are advised that similar schemes might be practicable for a considerable number of other commodities. The margin between minimum and maximum prices, and the provision for limited changes from year to year, can ensure a measure of stability for both importing and exporting countries while avoiding undue rigidity. There may still, of course, be large price fluctuations in the part of world trade in the commodity that is not covered by the agreement, and if these are too great the whole scheme may be threatened. An international buffer stock to limit price fluctuations in this field might be a useful adjunct to such a scheme.

Buffer stocks

74. To combine a buffer stock with some other arrangement that assured stability for a considerable part of the world trade in a commodity would also reduce the risk that a buffer stock agency would have to buy up too large a part of the world supply. This would be a danger if the agency's buying price were well above the level that would otherwise obtain, and if traders had no confidence in its ability to buy all that was offered at that price. The danger might be avoided by allowing an adequate margin between the buying and selling prices or by refusing to resell for a certain minimum period, thus inducing consumers to keep stocks for current use. The buffer stock agency could clearly not have unlimited financial reserves, but, even if it had to stop buying after a point, it would help to maintain the price in times of surplus by taking a part of the supply temporarily off the market.

75. It may appear futile to talk of buffer stocks at a time when they could not be built up without causing or aggravating a shortage of many commodities. But much time will certainly be required to agree on the details of any scheme. In any case, a minimum price set now, in a period of shortage, would provide a valuable assurance to producers; until stocks can be built up, excessive prices can be prevented only by import allocations or by fixing maximum prices.

76. A major problem in buffer stock schemes is that of finance. Storage costs may be substantial but manageable. Whether or not they are covered by the difference between buying and selling prices, any real cost to the world of carrying extra stocks may well be more than offset by the gains resulting from greater stability.

77. More serious, probably, is the problem of providing capital finance. Only a detailed examination by commodity experts could give any idea of the possible sums required, but these are likely to be substantial. Less might be required by buffer stock agencies if they could operate in futures markets and induce appropriate changes in stocks held and financed privately. (This would also relieve such an agency of the technical burden of storing commodities, though not of the need to pay indirectly for the cost.)

78. Much will depend on the willingness of governments to refrain from action that would jeopardize the whole scheme. For example, the sudden liquidation of stocks held by a government in connexion with a domestic price support programme, or the imposition of import restrictions by a major importing country, might throw too heavy a burden on an international buffer stock agency.

79. Whatever the capital finance required, we believe that in practice it will have to be provided both by importing and by exporting countries. Both, as we have seen, stand to gain from greater stability. Importing countries, in their own interest, would no doubt wish to subscribe to a scheme that was in any case being organized by exporters, in order to secure a voice in its policy.

80. If the participating countries contribute sufficient capital, a buffer stock agency organized and financed by exporting countries alone could obviously reduce the fluctuations in the world price of the commodity. When the agency came into possession of adequate supplies of foreign exchange, it would also be in a position to have an important influence on the subsequent flow of exchange to the exporting member countries. At the present time, however, the foreign exchange reserves of most exporting countries which are potential participants are small. It is hence likely that the initial assets of the agency would consist largely or wholly of exporters' currencies, and that it would have to go through a complete cycle of purchases and sales of the commodity before it acquired any substantial supply of foreign exchange. This means that a delay, and probably a long one, would intervene before the agency could begin to have much effect on the current flow of exchange to exporting countries. Moreover, any exchange contributed in advance by the exporting countries, or accumulated by the agency from its sales of the commodity, would obviously not be available to the exporting countries themselves during the periods when the agency held such exchange. This effective recurrent segregation of a part of their exchange reserves might be a serious disadvantage to the exporting countries. If importing countries also contribute to the agency's capital in their own currencies, on the other hand, the initial delay and the effective segregation of exporters' foreign exchange reserves could be avoided.

81. In addition to the other advantages of having the agency controlled by importers and exporters jointly rather than by exporters alone, it is therefore desirable that both groups should contribute to it, in order to assure that the full benefits of its operations will be available from the outset and to strengthen the reserve position of the countries exporting primary products—which are in many cases the poorer countries.

82. A buffer stock agency possessing a sufficient supply of the main currencies in which trade in its commodity is conducted could clearly do a great deal to smooth out not only price fluctuations but fluctuations in foreign exchange receipts due to swings of *demand* in importing countries. It would seek to replenish from its sale of the commodity, in years of abnormally high demand, the supplies of different currencies which it used up in making purchases in years of abnormally low demand. The management of the transactions of the agency to this end, in a régime of inconvertible currencies, would present difficult problems, which would need to be considered in detail in respect of each commodity, but the general effect would be in the right direction.

83. On the other hand, it should be noted that price stabilization, achieved by buffer stock purchases and sales in foreign exchange, would not of itself stabilize either producers' incomes or exporting countries' foreign exchange receipts against fluctuations in the *supply* of the commodity. It would be possible to devise a buffer stock scheme which would stabilize foreign exchange receipts in the face of such fluctuations. For example, the agency could purchase for the buffer stock in the exporter's local currency in the year of a bumper crop, and could give the exporting country the right to exchange this local currency for foreign exchange held by the agency in a bad harvest year. But the stabilization of producers' incomes in these circumstances would still remain a matter for separate action. A system of international crop insurance might also help to stabilize both producers' incomes and foreign exchange receipts.

84. For demand fluctuations in importing countries, with which we are mainly concerned, the key to stabilization of foreign exchange receipts along with prices is the offsetting of fluctuations in commercial demand by buffer stock purchases and sales in the currency in which the trade in question is normally conducted. No doubt the finance for this purpose will have to come largely from the countries chiefly concerned, but it would be useful to have a supplementary international source of finance. This would add flexibility to the range of currencies available for transactions and would reduce the extent to which the exporting countries, in effect, would be merely segregating part of their foreign exchange reserves for buffer stock dealings. The provision of international finance from a general pool would also act as an incentive to the organization of buffer stock agencies, either alone or in combination with other arrangements; it would ensure a degree of international sanction against types of schemes liable to abuse; and it would reduce the total finance required by buffer stocks, since

it is unlikely that the maximum financial needs of each buffer stock agency would arise at the same time. The International Bank for Reconstruction and Development might be an appropriate channel through which to obtain such finance, the more so since greater stability would contribute to the economic development of primary producing countries. It might be possible for the Bank (or some other international authority) to provide funds for the various buffer stocks on, say, a 50-50 basis; and, in raising any necessary loans itself, to pledge as collateral the total stocks of goods held.

Conclusions

85. We suggest that governments should reconsider the case for a series of commodity arrangements of various types as a means of keeping short-run movements of primary product prices, both upward and downward, within reasonable bounds, and of helping to stabilize the international flow of currencies. To this end, the International Bank for Reconstruction and Development might indicate that it is willing in principle to consider participating in the financing of commodity arrangements that involve buffer stocks. Progress in these directions would make an important contribution to the stability of industrial as well as primary producing economies.

86. We do not believe that any new international agency to administer a comprehensive scheme for a range of different commodities is necessary or practicable. The arrangements needed differ from commodity to commodity, and must be worked out and put into effect by the countries mainly concerned in each case. Co-ordination of general structure and policy amongst the various schemes is important, but international bodies—such as the Interim Co-ordinating Committee for International Commodity Arrangements and the International Materials Conference—already exist and can be used for this purpose.

87. The present shortage of many commodities does not reduce the urgency of the problem. We have already emphasized that detailed agreements take a long time to negotiate and that assurances to producers are required now, both to encourage production necessary to prevent continuing shortage and as a *quid pro quo* for the import allocations now being made. The possibility should be considered of converting these emergency schemes into permanent stabilization arrangements. It might also be possible at some future date to use for stabilization purposes the stockpiles acquired for strategic reasons.

88. It must not be thought that commodity arrangements could completely solve the problem of instability in world trade. Even if it were possible to make arrangements for the twenty-five most important primary commodites (by value) in world trade, this would cover only one-third of the total. In practice, it is most unlikely that agreements could be made within a reasonable period for so large a number of commodities, and many of those covered might be of comparatively trivial importance by

value—though possibly important for strategic or other reasons. Nevertheless, it might be possible, by concentrating on a small number of important commodities subject to the most violent fluctuations, to make a very substantial contribution to stability. It must not be forgotten that a stabilization scheme for one commodity will normally increase the stability of others for which it can be substituted either in consumption or in production, nor that the greater stability of producers' incomes in one field will help to stabilize demand for the manufactures and other products that they buy.

Chapter III

THE INTERNATIONAL FLOW OF CAPITAL

Stability in foreign trade and economic development

89. A basic objective of foreign investment policy, as of commodity policy, should be to keep the international flow of goods and services as steady as is consistent with long-term trends and with the inevitable structural changes in the world economy. Abrupt fluctuations in either the aggregate volume of trade or its geographic distribution only do harm. In the present chapter we examine the implications of this objective with reference to the general interest in maintaining a steady rate of economic development.

90. The maintenance of a steady volume of exports for foreign economic development is clearly important to the lending (capital-exporting) countries. Their own levels of employment depend partly on the production of these exports. If they suffer from recession, maintaining the flow of the exports will help support employment. Even if their domestic compensatory policies are effective, the temporary diversion of resources to domestic outlets in a period of falling exports entails great difficulties and waste. Similar considerations apply to those third countries whose own exports depend, in part, on purchases made from them by the borrowing countries with the proceeds of loans or equity investments which are "untied".

91. The importance of this steadiness of flow to the borrowing countries is even greater. If a recession occurs abroad, their current earnings from exports will fall. If the share of their imports that is financed by foreign capital also falls, both their own development programmes and their entire economies are likely to suffer further damage. The ability of borrowing countries to counter this double impact from abroad through domestic monetary and fiscal policies is often limited, and their resources often inadequate to maintain the previous rate of economic development without intolerable cuts in domestic consumption.

92. Indeed, there is a good *prima facie* case for expanding the rate of development in under-developed countries, in times of recession, through foreign lending. Such action would obviously help both lending and borrowing countries. The practical difficulties are great in most cases, however, and perhaps insuperable. Even for programmes already under way, it takes a good deal of time to accelerate the production and shipment of most capital equipment. It also takes time to put wholly new development projects into operation, even if the plans have already been prepared. In

both cases, if the recession does not last very long the effects are likely to be felt too late to do much good. Apart from variations made necessary by essentially technical considerations, as a rule the most useful and practicable general objective is therefore a steady rate of economic development.

Financing a steady rate of economic development

93. Steadiness in the rate of economic development may be impossible to achieve, however, without variations in the rate of foreign financing. Normally, foreign capital supplies only part of the funds required to carry out programmes of economic development. The rest is financed by domestic savings supplied by the borrowing countries themselves. But the domestic savings of such countries tend to vary with their income from exports. This source of funds is therefore likely to shrink in times of recession abroad. Moreover, the imports directly or indirectly required to sustain the programmes consist largely of capital equipment and other materials, which for technical reasons cannot readily be produced within the country. If foreign exchange receipts drop, these goods cannot be imported at the previous rate except at the sacrifice of other imports.

94. To prevent such cuts in imports, which it might be necessary to effect by trade or exchange restrictions, the country involved may elect to draw on its monetary reserves. It will not wish or be able, however, to reduce these below a certain point. It may also resort to the International Monetary Fund. But the amounts which the under-developed countries can count on drawing from the Fund are small in most cases. In any event, and even if the Fund's policies were liberalized in the manner suggested in the next chapter, the country may be unwilling or unable to borrow at short term in order to keep its long-term development programme going. It may therefore be compelled to cut its imports of capital goods, and thus damage both its own development programme and the economies of the supplying countries, unless it can increase the rate at which it obtains capital from abroad. If it can get sufficient additional long-term foreign financing, however, or can sufficiently increase the rate at which it draws on existing foreign loans or credits, it can continue to import at a steady rate the goods directly or indirectly required for the development programme.

Role of national and international lending agencies

95. We suggest, therefore, that all governmental or intergovernmental agencies which supply capital funds for foreign economic development should be prepared to vary the rate at which they provide these funds, in the light of fluctuations in the foreign exchange receipts of the borrowing countries on current account and on other capital account and within a total burden of external debt which the borrowing country can reasonably assume.

96. In a number of cases in which programmes of development in the borrowing countries have been financed in part by loans or grants from foreign governments, some attempt has already been made to apply policies

of this sort. The scope for such action by national governments, however, is necessarily limited.

97. The purposes and operations of the International Bank for Reconstruction and Development, on the other hand, make the Bank an eminently appropriate agency for the implementation of the proposed policy on a more general scale. In essence, the Bank should stand ready to provide increased outflows of funds to member countries for development purposes in times of recession in the countries to which they export. The chief requisites for a practical programme of this sort are that (*a*) a general development programme be established well in advance, normally in co-operation with the Bank, so that if necessary the rate of the Bank's lending can be expanded without undue delay; and (*b*) the Bank's resources be adequate to meet such additional demands, in the event of a decline in the country's export income or in its other means for financing the programme.

98. Various situations may arise in which the Bank could properly take action in accordance with the principles just outlined. The most usual would probably be that in which the Bank and the borrowing country had previously agreed on a development programme, which was being partly financed by the Bank. If the borrowing country's own export receipts now drop substantially, it should be allowed to increase the rate of its drawings against the Bank's loan, and thus be put in position to maintain a steady rate of importation of the goods and services required. The recent increasing participation by the Bank not only in specific projects in the narrower sense, but also in broad programmes of general economic development, may provide an opportunity for the application of the principles here suggested.

99. Again, there may be an agreed development programme in which private foreign capital is also participating, as well as the Bank. If the volume of this private participation falls, the Bank should give consideration to increasing its own participation correspondingly. Such action is not likely to be feasible, however, except with respect to private foreign investment made through loans to governments or quasi-governmental institutions. It would be difficult or impossible for the Bank to take over the supplying of capital previously provided by foreign equity investment, the more so since the latter also usually involves the provision of managerial skill and initiative, technical knowledge and even personnel. This is at present the principal form of international private investment.

100. In a third type of case, the borrowing country may have no programme which has been agreed in advance with the Bank, but may find that a fall in its export income threatens the imports of capital goods and other items necessary to its own development plan. If its situation is such that it can reasonably assume an additional external debt burden, it may then appropriately turn to the Bank for help.

101. Substantially similar problems may arise if the country's development programme had previously been financed in part by loans or grants

from foreign governments, without any previous participation by the Bank, and if the inflow of funds from these sources drops seriously for any reason. There may then be a case for seeking countervailing assistance from the Bank. A recession in the lending countries, however, is not itself likely to cause governments to reduce such loans or grants sharply, and perhaps not at all. It is true that difficulties may arise if the lending country finds its own balance of payments under pressure because of a recession in a third country, and on this account is forced to curtail its foreign investment, but the cases in which such curtailment would be necessary are of limited significance at present. This possibility apart, the chief danger is rather that the loans or grants may be abruptly reduced or terminated for reasons of other sorts. If they had previously been large, it might be impossible for either the Bank or any other available agency to offset the effects of sudden reductions, at least by measures of the type suggested in this chapter. In view of the great damage which would result, it is therefore to be hoped that governments will avoid such drastic measures.

Adequacy of the International Bank's resources

102. If the Bank is to undertake operations of the sort proposed, it must be prepared to expand the rate of its disbursements on outstanding loans, and perhaps to make additional loans, on short notice.

103. At the present time, it is difficult to anticipate the size of the fluctuations which the Bank may be called upon to offset. The answer will turn in large part on the extent to which a country's development programme can be jeopardized by declines in its exports, or in other foreign investment in the programme. This in turn will depend primarily on the success of the major industrial countries in preventing substantial internal recessions. The need for help, which will vary from country to country, will also turn in part on the country's ability to smooth out fluctuations in its capacity to maintain imports by the use of its own monetary reserves, and by the use of any additional resources it may obtain from the International Monetary Fund. It will likewise be reduced in proportion to the effectiveness of any international commodity arrangements into which the country may enter.

104. Given the continued prospect of occasional short but possibly sharp recessions in one or more of the leading industrial countries, however, the need for assistance from the Bank to carry out effective policies of the types here suggested is clearly likely to be substantial. We are concerned lest the Bank's present resources prove seriously inadequate for the task, both in total volume and in flexibility. This concern arises not only from the present size of the Bank's resources but, more particularly, from its dependence upon the private capital market as the main source of funds for its loan and guarantee operations. Under its Articles of Agreement, only 20 per cent of the Bank's subscribed capital can be used for making loans. Any additional lending must be financed through the sale of securities. In order to expand its lending operations in time of recession, therefore, the Bank would either have to conserve a substantial amount of liquid

resources borrowed in good times, or increase its security sales during recession.

105. Either course presents practical difficulties. To sell its securities the Bank must rely primarily upon private institutional investors, whose capacity and desire to absorb the Bank's bonds is clearly not unlimited. Their willingness to buy securities related to foreign undertakings may be especially restricted at just that time, at the onset of a recession, when the Bank may particularly need additional resources. It is hence clearly undesirable that the Bank should continue to be so heavily dependent on so inelastic a source.

106. There appear to be several possible lines of solution. First, under the Articles of Agreement 20 per cent of the Bank's subscribed capital is paid in; but of this sum 18 per cent is payable in the member's own currency and is available for loans only with the approval of the member in each case. In the event of a recession, members that now limit the extent to which the Bank can utilize this part of their subscription might approve the release of a larger portion. Such a step would be the more attractive in times of falling international demand because it might help to maintain the level of activity in the member's export industries, without entailing any loss of foreign exchange that might otherwise be earned from current exports; but it is unlikely to increase greatly the volume of available funds. Second, the proportion of the Bank's capital which is paid in, the 20 per cent referred to above, might be increased. So far as members approve the lending of their currency, this would also augment the funds actually at the disposal of the Bank for making loans. To effect an increase, however, would require an amendment of the Articles of Agreement themselves. Third, in the event that the Bank encounters difficulties in placing its securities with private investors, it might borrow from the governments or central banks of the lending countries, under conditions safeguarding the interests of private holders of Bank securities. From the point of view of the lending countries, this would provide a more flexible method. Moreover, it would not require an amendment of the Articles of Agreement, though in certain cases national legislation might be necessary. Fourth, the Bank's total subscribed capital might be enlarged. This step will be called for, in any case, when the Bank approaches the limits of its power, now fixed by its Articles of Agreement, to borrow and to guarantee.

107. Whatever the alternative selected, however, we feel that prompt action should be taken to increase substantially the total volume of resources available to the Bank. An increase would probably be necessary, in any event, to enable the Bank to carry out effectively the policies proposed above. It would likewise be necessary if the Bank later shares in the financing of the commodity stabilization operations suggested in the preceding chapter. Finally, such an increase will also be required to enable the Bank, as appropriate conditions are created, to participate on a much larger scale than hitherto in broad programmes of economic development.

Chapter IV

INTERNATIONAL MONETARY RESERVES

The need for reserves

108. However successful the measures proposed in the two preceding chapters in the fields of commodity trade and international investment, considerable fluctuation is bound to persist in the foreign exchange receipts of many countries. They will be able to maintain a reasonably stable flow of imports, and to avoid periodic tightening of fiscal and monetary policies or of trade and exchange restrictions, only if they have adequate monetary reserves, including reserves indirectly available in institutions such as the International Monetary Fund.

Inadequacy of existing reserves

109. Our examination of existing reserves has convinced us that they are not in general adequate. The total reserves of countries other than the United States are now much smaller in relation to trade than they were before the war. Their total gold and official dollar holdings at mid-1951 were only one-fifth higher than they were in 1937. But their total imports, measured in dollars, have recently been running at an annual rate more than two and one-half times as great as in 1937, largely the result of the rise in prices. Their imports from the United States have been nearly five times as great. Their reserves can thus serve as a buffer only against much smaller proportionate fluctuations in trade. There has also been a heavy increase in holdings of sterling, but a large part is not freely usable or convertible and cannot be included in free reserves. The recovery of gold and dollar reserves outside the United States between 1949 and mid-1951 has likewise been substantial, but has been accompanied by a similar rise in the dollar value of trade.

110. Present reserves of some countries may, it is true, be as high in relation to trade as they were in certain periods before 1937, but the need is now greater. In the past, foreign exchange deficits resulting from a fall in export receipts could often be offset by allowing, or encouraging, employment and incomes to fall, thus reducing the demand for imports; but most governments cannot now allow unemployment on any large scale. In the past, at least before 1914, short-term capital often flowed to countries with temporary deficits, thus reducing the need for reserves. Now, short-term capital tends all too often to leave countries that are in difficulties. Only a part of such disequilibrating movements can be prevented by exchange control and, until much more confidence can be restored in the stability of

exchange rates and in political stability in general, they will continue to be a danger against which substantial reserves must be kept.

111. Countries other than the United States now have (October 1951), on an average, gold and dollar reserves equal to about 25 per cent of their annual rate of imports. Only a part is, of course, normally available to meet international deficits. Many countries are obliged, for legal or psychological reasons, to hold gold and foreign exchange as backing for their currency, and few would, in any case, be prepared to use their whole reserve, save in extreme emergency such as war. Reserves are also, inevitably, unevenly distributed. For a few countries they are at present adequate. For many, especially in Europe, they are less than 25 per cent of annual imports; for some, less than 10 per cent. But even a reserve of 25 per cent that can all be freely used is by no means excessive. Experience shows that a country's export proceeds can easily fall by 25 per cent between one year and the next. A rumour of currency devaluation that advanced exchange transactions relating to imports by an average of only one month, and delayed transactions relating to exports and other receipts by one month, would lead to a drain on reserves equivalent to two months' imports.

112. Many countries have lost gold and dollar reserves, in twelve months or less, equivalent to 20 to 25 per cent or more of their annual imports, even during periods of high world demand. A few important examples are the United Kingdom in 1938 and 1939,[1] France and Mexico in 1946, Argentina, Canada, Sweden and Turkey in 1947, the Union of South Africa in 1948 and the United States in 1950 and 1951.[2] Many other countries would no doubt have suffered similar losses had they had reserves to lose and had they not been forced to restrict imports.

113. It is noteworthy that the large reductions in United Kingdom reserves in 1938 and 1939, and in United States reserves in 1950 and 1951, led to no crisis and no intensification of import restrictions; the reserves were in each case adequate. By contrast, the fall in United Kingdom reserves in 1949, though much smaller in relation to trade, led to an exchange crisis and additional restrictions.

114. The International Monetary Fund provides a comparatively trivial supplement to national reserves, assuming no waiver of the rule limiting members' annual purchases of foreign currencies to 25 per cent of their quota. On an average, this represents a mere two and one-half per cent of members' annual imports.

115. The Fund's holdings of gold and dollars ($2,800 million) would, moreover, soon be exhausted in trying to offset more than minor fluctuations in a supply of United States dollars that has recently been running at over $20,000 million per annum, excluding military aid. They might suffice to offset fluctuations in United States imports as great as those in 1949, but

[1] September 1938 to August 1939.
[2] July 1950 to April 1951.

a twelve-month reduction in dollar supply of the same relative severity as that in 1937 and 1938, even if followed by a quick and full recovery in the following twelve months, might well mean a reduction of as much as $10,000 million in the supply of dollars over the whole period of two years.[3] Even assuming that countries had previously been running a surplus in their balance of payments with the United States (as many had for a short time before mid-1951), that they could use a part of their own reserves, and that United States export prices might fall to some extent, the remaining reduction in their dollar purchasing power would be far larger than could be met by the Fund's present resources.

116. All these facts seem to show that reserves of countries other than the United States, even when supplemented by recourse to the Fund, are in general barely sufficient to meet the unforeseen emergencies (such as crop failures, political changes and rumours, and foreign exchange speculation) that arise in the affairs of most countries from time to time, even in periods of general world prosperity. Existing reserves would not enable countries, in addition, to maintain their imports in the face of a recession in one or more major countries that sharply, though only temporarily, reduced the demand for exports throughout most of the world. Statistics apart, a substantial reduction in the supply of dollars would inevitably lead to widespread exchange crises and a rapid growth of trade restrictions and exchange control. We must therefore examine the various ways in which reserves might be increased.

Methods of increasing reserves

117. One method would be to raise the price of gold uniformly in terms of all currencies, as provided for in the Articles of Agreement of the Fund. Measured in dollars, the official price of gold is no higher than before the war, while prices in international trade have doubled. The effectiveness of a given gold reserve as a buffer against trade fluctuations has been halved. Increases of 25, 50 or 100 per cent in the gold price would raise the reserves of countries other than the United States by some 3,000, 6,000 or 12,000 million dollars.

118. It may be that a higher gold price would set in motion inflationary forces which would be undesirable save at a time of deficient effective demand. It is, however, possible by appropriate banking policy to prevent greater reserves from affecting national monetary conditions, at least where the banking system is sufficiently developed. Higher reserves would, moreover, increase confidence in many currencies that have suffered repeated devaluations in the last twenty years. If such confidence reduced the fear that every exchange crisis would necessarily lead to devaluation followed by higher prices, the prevention of inflation would be facilitated.

119. A higher gold price would, of course, stimulate gold production and this would in a sense be wasteful. But only a small fraction of one

[3] See annex for details.

per cent of the world's resources would be involved, and the loss would be offset many times over if higher reserves reduced the danger of international crises, trade restrictions and unemployment.

120. The benefits of a higher gold price would be uneven. Countries with low gold reserves would gain little; those with high reserves, or with a substantial gold-mining industry, would gain disproportionately. There is also a danger that some countries would soon spend the increase in the value of their reserves, rather than keep it as a buffer against trade fluctuations.

121. Whatever the balance of the economic arguments, it is clear that a change in the price of gold raises many political problems and, while all other methods of increasing reserves involve international credits or grants—matters that also raise difficult questions for governments—we have thought it appropriate to restrict our more detailed analysis to these other methods.

122. Some would involve bilateral arrangements. These include stabilization loans from one country to another and the mutual granting of lines of credit to cover swings in trade balances between two countries. We have, however, confined our attention to multilateral arrangements. These could be of various types. Funds could be made more or less unconditionally available to meet deficits within specified limits, as in the European Payments Union. Funds could be made available, instead, in amounts determined by more or less precise rules agreed upon in advance, as in the plan proposed in *National and International Measures for Full Employment*. Under this plan, countries suffering from a fall in their own effective demand would make their currency available to the rest of the world. Finally, funds could be made available by an international authority at its discretion, limited only by agreed general principles and by its total resources, as in the International Monetary Fund.

123. In making a choice among the various possible methods, we have been influenced, first, by the difficulty of formulating precise rules in advance. However carefully these may be devised, they will often be inapplicable to future situations.

124. Second, we are impressed by the need to make finance available as quickly, as cheaply and as freely as possible at the onset of a recession, to prevent an unnecessary contraction of trade.

125. Third, we recognize that the provision of the necessary additional international reserves must include the extension of credit through international institutions by those countries whose currencies are chiefly needed and acceptable. At the present time, the need is primarily for United States dollars. Additional dollar resources are, however, unlikely to be provided, at least to meet what are regarded as normal fluctuations, unless there are firm assurances that the resulting contribution to international reserves will not be dissipated but will constitute a truly revolving fund. One way

of ensuring this would be to exercise a strict control of the use of the resources, but this would run counter to the second principle mentioned above. A better way, we believe, would be the enforcement of more definite provisions for repayment of any funds drawn.

The International Monetary Fund

126. We are reluctant to recommend the creation of yet another new international organization to achieve these various objects. The International Monetary Fund already exists and should be used. Nor do we think it useful to segregate a special account within the Fund to deal with the problem of recession, since this would reduce its flexibility. Certain changes will, however, be required in the structure and policies of the Fund. This does not necessarily imply that policies hitherto adopted have been mistaken but rather that they may have to be different in the situation we are considering—a recession in one or more major countries that sharply, though only temporarily, reduces the demand for exports from most of the world. Some of the changes we suggest may, however, be useful even should this situation not arise. We consider first those changes that can be made without additional finance. We do not believe that the problems we have described can be satisfactorily solved without it, but we recognize that its provision raises special political difficulties.

(i) *The 25 per cent rule*

127. The limitation of a country's right to buy foreign exchange from the Fund in any one twelve-month period to 25 per cent of its quota may mean that it cannot make full use of the drawing rights normally available to it in less than four or five years. This greatly limits the use of the Fund, especially in dealing with those short sharp fluctuations in trade and payments that we believe are likely to occur. It makes ineffective a large part of the Fund's resources, whose adequacy is in any case open to doubt, at times when they are most needed. We believe that the Fund should make free use of its right to waive this 25 per cent rule, especially at such times. The fear that this might lead to an irrevocable loss of its most valuable currencies would be largely removed by enforcement of the stricter repurchase provisions described below. These provisions would also diminish the danger that currencies in greatest demand, such as dollars, would be inequitably distributed. In any case, the gold and dollar holdings of the Fund are nearly two-thirds of the total of dollars that could at present be requested by all members other than the United States, even if the 25 per cent rule were completely waived to the extent of members' quotas; and it is unlikely that every member would wish, or would be eligible, to draw on dollars to that extent. It would be advantageous, for other reasons, to have more gold and dollars in the Fund, but the present limited holdings should not inhibit waiving of the 25 per cent rule.

128. In appropriate cases, the Fund should also be prepared to waive the rule that its holdings of a country's currency cannot exceed 200 per

cent of the quota, especially for countries whose quotas are unusually low in relation to the trade fluctuations to which they are subject.

(ii) *Repurchase provisions*

129. The present arrangements in general oblige a country that has sold its currency to the Fund for foreign exchange (that is, borrowed) to repurchase the currency (that is, to repay) when, among other conditions, its reserves increase. We believe that this provision should be retained, but that in appropriate circumstances the Fund should also agree with members on fixed dates for contractual repurchase, a procedure that has already been adopted in several instances. The present repurchase obligation is indefinite with respect to changes in reserves in the sense that the member has a specific obligation to repay only in consequence of possible future increases in its own reserves that may not actually occur, and the dates of which cannot in any event be predicted at the time of borrowing (and even this obligation is subject to certain exceptions). The procedure just referred to, on the other hand, would permit the establishment of a firm commitment to repay at a specified date or dates. This would ensure that the resources of the Fund would not be in danger of becoming frozen but would effectively revolve, and would hence make it easier for the Fund to lend in cases of doubt. Countries will not make such firm commitments irresponsibly; in the last resort they can and must repay out of their own reserves.

130. We recognize that such an arrangement may also reduce the willingness of countries to borrow; some may prefer to restrict their imports to meet a deficit, rather than to mortgage the future. This is a real dilemma and the Fund will have to use its judgment in deciding, in particular cases, whether, or in what form, to impose the extra repurchase provision. As an assurance to prospective borrowers it might be provided that, when such an arrangement was made at a time of recession or when there had been, for any other reason, a substantial fall in the international disbursements of an important country or countries below what was regarded as a normal long-term level, the Fund should have power to postpone repurchase obligations if, in its opinion, a normal situation had not yet been restored.

131. Since we are contemplating a world in which occasional short, sharp fluctuations interrupt a steady upward movement in trade, it would seem appropriate to spread the compulsory repurchase over a period of time. In this way countries could maintain a steady rate of importation at a level not far below that which would be possible were no lapses to occur—borrowing from the Fund during the comparatively short periods when their export earnings were abnormally low, and repaying more slowly during the longer periods of prosperity. Such a provision would also increase the willingness of countries to borrow instead of restricting imports.

132. Their willingness might be further increased if the Fund deferred enforcement of the present rule that, contrary to the general provision

proposed above, obliges members, at the end of the financial year in which they have borrowed, to repay half of the amount borrowed even if their reserves have remained constant during the year. This rule may unduly discourage members that have drawn freely on their own reserves before approaching the Fund.

133. The present obligation to repay in gold or convertible currency appears to have limited requests to the Fund for currencies other than dollars. We suggest that the Fund should consider ways of allowing repayment in the currency borrowed. This would help members to meet temporary shortages of currencies that are not completely convertible, including shortages caused by recessions in countries other than the United States.

(iii) *General policy of the Fund*

134. We have already made clear our view that, in the event of a substantial fall in the disbursements of an important country or countries, the Fund should make its resources freely available. We are not suggesting that it should make a formal decision that such a substantial fall has started, and thereafter adopt a more lenient policy. This might cause dangerous delay. So long as uncertainty exists, a member country requesting assistance should be given the benefit of the doubt. The Fund's main criterion should be whether the member can be expected to repay. This involves, among other things, judging whether its foreign exchange receipts have fallen below the average level at which they can be maintained over the coming years. But if the Fund finds it hard to make such an estimate, it should in general accept the judgment of the member, provided the latter makes a definite repurchase commitment.

135. In making any estimate of the future average receipts of a member, the Fund should disregard the possibility that a recession in a major country may develop into a serious depression. It should assume either that corrective action will be taken or that the country in question will take other steps to avoid undue contraction in its disbursements to the rest of the world. If these assumptions prove erroneous, imports from the country will have to be reduced accordingly, but it would be most undesirable, by withholding funds, to force countries to restrict imports whenever a recession begins, on the assumption that it will be a major one. Nor should the Fund, at the onset of a recession, attempt to conserve its resources for use in a major depression should this develop. There would be no purpose in withholding resources when they are needed in order to use them when it is too late.

136. At the other extreme, the Fund should not refuse assistance to a member suffering from a temporary fall in exports to a major country on the ground that no serious unemployment has developed there, and that any reduction in output, prices or inventories represents a healthy readjustment. This is irrelevant. A very small drop in employment in the United States, for example, may be accompanied by inventory changes that lead

to violent declines in the imports and prices of certain commodities. The important question is whether the reduction in the value of imports is temporary or permanent. Thus, developments in the United States in 1949 may or may not have been healthy; but to have argued against assistance to a country suffering a sharp but temporary fall in its exports to the United States in that year, on the ground that developments in the United States were healthy, would have been quite beside the point.

137. There may be a natural reluctance to make the resources of the Fund available to any member that is pursuing restrictive or other policies not in keeping with the Fund's long-run objectives. But to refuse assistance to an important country when its exports are falling might well have the opposite effect, by forcing members to intensify their restrictions. Some progress has been made in recent years towards a multilateral, non-discriminatory world with a minimum of exchange and trade restrictions, and it is precisely because we believe in the need to continue such progress that we think it so necessary for the Fund to follow a lenient policy at times of falling demand. Otherwise, the next substantial recession may well wipe out the gains of the last five years. The Fund's aim at such a time should be to limit the growth of restrictions by making funds freely available. Assistance should certainly be forthcoming to a member, whatever restrictions it is imposing, provided these are not intensified. It may even be necessary in practice to allow some increase in restrictions by members that are anxious about their future level of earnings, and whose responsible leaders do not feel able to meet the whole of their deficit by borrowing and thus burdening the future. Advances from the Fund will then perform a service if they limit the increase of restrictions.

138. Indeed, it may be that the Fund, far from being overwhelmed by a flood of requests for assistance at times of falling demand, will find that its main problem is to induce countries to accept assistance as an alternative to restriction. One method would be to reduce service and interest charges. While the interest charges are relatively low for limited, short-term borrowings in excess of the member's quota, the marginal rates now rise substantially for longer periods and larger amounts, and may inhibit use of the Fund's resources at times when they are most needed to check a cumulative wave of restriction.

(iv) *Size of the Fund's resources*

139. The general policies described in the preceding sections could be carried out by the Fund with its existing resources. But, as we saw earlier, it will be unable to cope with more than minor fluctuations unless its resources are substantially enlarged. Failing this, a reduction in imports into the United States of the severity of that in, say, 1937 and 1938, would inevitably lead to widespread restrictions in other countries, and a reduction in their imports from the United States to the level that could be paid for. If the United States feels that such a recession would involve a failure to

meet its international obligations to maintain high and stable levels of employment, even though not necessarily through any fault of its own, or if it regards the maintenance of its exports as a national interest, it could avoid excessive restrictions on its exports by increasing its subscription to the Fund. It is desirable that this should be done in advance, since recessions can develop quickly. The subscriptions of other members should be increased at the same time, but it would not be necessary to increase all in the same proportion. The opportunity might be taken to revise their distribution, which is at present very unequal, ranging from 1 to 30 per cent of members' annual imports. Major criteria in revising members' quotas should be the probable extent of fluctuations in their trade with the world as a whole and with the United States in particular, regard being paid to the special problems of under-developed countries described in chapter I.

140. If an increase in subscriptions proves impracticable, reliance will have to be placed on the borrowing powers of the Fund. If, for example, there were more than a mild recession in the United States, and if the policies proposed above were pursued by the Fund, after a time its holdings of gold and dollars would approach exhaustion. As provided for in the Articles of Agreement, the Fund could then seek to borrow dollars from the United States. If the latter decided, for reasons given in the preceding paragraph, to make additional dollars available, the Fund would be able to offer them to members on terms of repayment and interest similar to those offered by the United States. The deeper the recession the easier these terms would have to be, if countries were to be induced to borrow still more rather than to meet their deficits by further import and exchange restrictions.

141. The choice must in the last resort be with the country suffering from recession. Is it prepared to make its currency available to other countries, through the Fund or in any other way? Such action would help to maintain its exports (and so help to maintain its own employment) and limit discriminatory restrictions against them—restrictions which may prove hard to remove when the recession is over. Needless to say, the more other countries can rely in advance on the availability of finance should a serious recession occur, the more liberal their economic policies are likely to be, and the less they will feel compelled to isolate themselves from major countries liable to large fluctuations. The prospect of serious difficulties in transferring payments for the service on foreign investments will also be reduced, and the international financing of economic development will thus be encouraged. These are strong arguments for an increase in the resources of the Fund at the earliest possible moment.

142. At the time of the Bretton Woods Conference in 1944, there was some doubt about the adequacy of the Fund's resources. But even if they were just adequate then, they cannot be adequate now, since the general price level (as measured by United States wholesale prices) is some 75

per cent higher. This inference is consistent with the conclusions we have reached by quite another route.

143. It may seem strange to advocate an increase in the resources of an institution which has used only a fraction of its resources in its first four and one-half years of operation. But these years have been exceptional. The Fund was intended to meet temporary deficits. It was right to bar countries receiving aid under the European Recovery Program from access to its resources. During the last year or more, most members have enjoyed unprecedented export receipts, and few have had good reason for recourse to the Fund. But if our analysis is correct, there may well arise in the future urgent, general and perfectly proper demands for access to the Fund. If it is to perform its functions fully in these circumstances, the Fund may well need substantially larger resources than it now possesses.

Annex

EXPLANATION OF FIGURE OF $10,000 MILLION IN PARAGRAPH 115

United States merchandise imports, as calculated for balance of payments statistics, were running at a quarterly rate of $3,200 million in the first half of 1951. If there were a twelve-month fall from this level in the same proportion as the fall, quarter by quarter, between the second quarters of 1937 and 1938, followed by a similar rise to the original level, the successive quarterly figures (in thousand millions of dollars) would be as follows: 2.8, 2.4, 1.9, 1.7, 1.7, 1.9, 2.4 and 2.8. The total value of imports over the two years would be $17,600 million, or $8,000 million less than it would have been had imports remained at the $3,200 million level throughout.

In the year ended 30 June 1951, United States invisible payments on current account (including private remittances but not government unilateral transfers) were $3,500 million (gross). If, over the twelve months in which merchandise imports were falling, these invisible payments fell below this level in the same proportions, item by item, as they fell between the years 1937 and 1938, there would be a reduction of $500 million, and a similar reduction below the original level during the next twelve months of recovery, making a total reduction of $1,000 million.

The total reduction in current payments would thus be $9,000 million. Allowing for a possible reduction in United States private long-term capital outflow, and for possible short-term capital movements into the United States induced by fear of the effects of a United States recession in foreign countries, there might easily be a total reduction of $10,000 million in the supply of dollars available to the rest of the world for purchases in the United States without drawing on reserves. This calculation takes no account of possible changes in United States Government grants and loans which have recently been running at an annual rate of some $5,000 million.

Supplement

EXTRACTS FROM RESOLUTIONS 290 (XI) AND 341 (XII) OF THE ECONOMIC AND SOCIAL COUNCIL

The present report was prepared pursuant to the provisions of paragraph 19 of resolution 290 (XI) and paragraph 5 of resolution 341 (XII)

Extracts from Resolution 290 (XI) of 15 August 1950

THE ECONOMIC AND SOCIAL COUNCIL,

Having in mind the obligations of Members of the United Nations under Articles 55 and 56 of the Charter to take joint and separate action to promote higher standards of living, full employment and conditions of economic and social progress and development,

Having considered the experts' report on *National and International Measures for Full Employment,* the report of the Economic and Employment Commission (fifth session) and the views of various specialized agencies and non-governmental organizations . . .

A. WITH THE OBJECT OF ENSURING REGULAR SYSTEMATIC CONSIDERATION OF EMPLOYMENT PROBLEMS BY THE COUNCIL

1. *Decides* to place on the Council agenda once each year, beginning in 1951, for consideration in the light of economic trends, the problem of achieving and maintaining full employment with progressively improving levels of production, trade and consumption, and maintenance of or progress towards the achievement of equilibrium in balances of payments . . .[1]

C. WITH THE OBJECT OF ENCOURAGING EFFECTIVE INTERNATIONAL FULL EMPLOYMENT POLICIES

I

9. *Recommends* that each Government intensify its efforts, while pursuing its employment and other domestic goals, to achieve and maintain equilibrium in its balance of payments; such equilibrium should be at the highest possible level of mutually beneficial trade and should be characterized *inter alia* by:

(*a*) Conditions of trade involving, along the lines envisaged in the relevant international agreements: (i) the absence of quantitative restrictions on international trade imposed for balance of payments reasons and of exchange restrictions on current account transactions (as defined in the Articles of Agreement of the International Monetary Fund), (ii) a reduced level of other trade barriers and (iii) a minimum of discrimination in the application of such trade, monetary or investment restrictions as may still exist;

(*b*) A level of reserves of convertible currencies and gold which would be sufficient to enable a country to meet normal fluctuations in its receipts of foreign exchange; and

(*c*) An increased and stable flow of international investment funds . . .

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[1]Section B of the resolution refers to the object of encouraging effective domestic full employment policies.

II

15. *Recommends* that Governments:

(*a*) Achieve and maintain, to the extent feasible, a high level and regular rate of flow of international investment capital for development purposes;

(*b*) Strive to prevent lapses in the flow of international investment resulting from or associated with economic recessions; and

(*c*) Continue to co-operate in efforts to achieve these results by both national and international measures;

16. *Recommends* that Governments:

(*a*) Seek to avoid, in their economic policies and programmes, measures which would be likely to have seriously adverse effects on the balance of payments or employment levels of other countries;

(*b*) In the event of a domestic recession, adopt, to the extent feasible, measures to offset the adverse effects of such recession on the balance of payments or employment levels of other countries; and

(*c*) Continue to co-operate in investigating ways and means for preventing domestic recession from spreading to other countries;

17. *Urges* the International Bank for Reconstruction and Development, while achieving and maintaining in ordinary times a high level and steady rate of flow of international investments for economic development, to utilize in case of recession, all practicable opportunities of increasing its resources, in order to expand the volume of its lending, *inter alia*, by making fullest use of its borrowing capacity;

18. *Urges* the International Monetary Fund to make its resources available to its members to meet needs arising from economic recessions as fully and readily as its Articles of Agreement permit;

19. *Requests* the Secretary-General to appoint a group of three to five experts to make technical studies and, after seeking the views of the International Monetary Fund and the International Bank for Reconstruction and Development, to prepare a report in accordance with the objective of paragraphs 15 and 16 above, formulating and analysing alternative practical ways of dealing with the problem of reducing the international impact of recessions that may arise, the report to be submitted to the Secretary-General and issued on the responsibility of the expert group;

20. *Requests* the Economic, Employment and Development Commission to study the report prepared under paragraph 19 above and to make recommendations thereon to the Council at its fourteenth session . . .[2]

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[2]By resolution 414 (XIII) of 18, 19 and 20 September 1951, the Economic and Social Council decided to discontinue the Economic, Employment and Development Commission from the beginning of 1952 to the end of 1954. It decided to place on the agenda of the Council each year an item on economic development and an item on full employment.

Part D of resolution 290 (XI) refers to the object of facilitating the Council's further consideration of the problem of unemployment, particularly in the less developed countries, and part E to the object of facilitating the implementation of the resolution.

Extracts from Resolution 341 (XII) of 20 March 1951

THE ECONOMIC AND SOCIAL COUNCIL,

Noting with interest the *World Economic Report, 1949-50,* prepared by the Secretariat,

Taking into account General Assembly resolution 406 (V) and

A

Considering that:

(*a*) The maintenance of international peace and security, the creation of conditions of economic stability, and the improvement of the standards of living of the world's population are permanent objectives of international economic and social co-operation among the United Nations,

(*b*) Continued progress in creating conditions of economic stability and in improving standards of living requires increases in the production of food, raw materials and manufactured goods,

(*c*) In the under-developed countries, progress toward the objectives enumerated in paragraph (*b*) above is limited by the characteristics of their present economic structures, which are reflected in the nature of their foreign trade, in the vulnerability of their terms of foreign trade, in their dependence on foreign countries for capital goods, in low levels of investment and in other factors both external and internal which contribute to their low living standards,

(*d*) Some of the adverse factors enumerated in paragraph (*c*) above are being aggravated by new inflationary pressures, shortages of goods, regulation of prices at different relative levels for different products, and re-allocation of productive factors, which are likely to affect unfavourably the rate or pattern of economic development of some countries,

(*e*) In the industrialized countries, particularly those which are faced with the task of reconstruction and re-equipment as the result of war damage, the additional tasks assumed as a result of the international situation are likely to cause inflationary pressures,

(*f*) Instability of prices in international markets also affects industrialized countries and, in many of them, aggravates internal disequilibrium and makes more difficult the necessary increase of their production.

(*g*) If appropriate measures are not taken, difficulties may arise in trade between the industrialized countries and the under-developed countries when present inflationary pressures subside and when reconversion of defence industries occurs; and some of these difficulties would tend to increase the difference between the levels of their respective productive capacities and also to increase the vulnerability of their economies to a decline in the demand for their products and to a fall in the prices of these products in world markets, with consequent unfavourable economic and social effects,

1. *Recommends* that all Members of the United Nations, during the period of general shortage of goods, take special measures to bring about adequate production and equitable international distribution of capital

goods, essential consumers' goods and raw materials especially needed for the maintenance of international peace and security, the preservation of standards of living and the furthering of economic development;

2. *Recommends* that all Members of the United Nations, during the period of general inflationary pressure, take measures, direct or indirect, to regulate at equitable levels and relationships, the prices of essential goods moving in international trade, including capital goods, essential consumers' goods and raw materials;

3. *Recommends* that the equitable regulation of distribution and prices referred to in recommendations 1 and 2 above be maintained as long as strong inflationary pressures persist, in order to minimize changes in the purchasing power, in terms of imports, of current earnings from exports as well as of monetary assets;

4. *Recommends* further that all Members of the United Nations take all steps in their power to prevent the development of inflationary pressures, thereby preventing speculative profits and maintaining the purchasing power of the poorer sections of the population;

5. *Amends* paragraph 19 of Council resolution 290 (XI) to request that the group of experts to be appointed under that paragraph include in its report recommendations concerning the appropriate national and international measures required to mitigate the vulnerability of the economies of under-developed countries to fluctuations in international markets, including measures to adjust, establish and maintain appropriate relations between prices of raw materials, on the one hand, and essential manufactured goods on the other, and thus to ensure greater economic stability; and

6. *Requests* all Members of the United Nations to report to the thirteenth session of the Council on such action as they have taken under the present resolution . . .[8]

[8]Part B of the resolution refers to the further consideration of the United Nations *World Economic Report, 1949-50* at the thirteenth session of the Economic and Social Council.