



BRETTON WOODS REVISITED

Remarks by

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at

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Luncheon Meeting

TORONTO, CANADA

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Address by Gabriel Hauge, President of the  
Manufacturers Hanover Trust Company, New York,  
at Luncheon Meeting of The Canadian Club,  
Toronto, Canada, Monday, February 24, 1969

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Recently I came upon this rather engaging commentary  
on Canadian-U. S. relations some thirty years ago:

"The border is an invisible line that one simply  
flies, drives, walks or swims across, a matter  
of no moment. One has to strain for a sense of  
the distinction - as in the case of a famous  
cannonball once lobbed by the Detroit Symphony  
Orchestra onto the Canadian side of the river  
during an over-enthusiastic version of Tchaikovsky's  
1812 Overture. This produced a momentary huffiness  
on the north side of the river and embarrassment  
on the south, as the need for diplomatic channels  
to resolve the damage showed everyone up as a  
foreigner."

On both sides of the border we are, of course,  
fully aware of the close ties between Canada and the United  
States and I do not propose to force that proverbial open  
door here today. But because our money and capital markets  
are so inextricably interwoven, it may be appropriate to  
comment on the state and prospects of the international  
monetary system.

There have been two striking illustrations in  
recent years of the intimacy of our interdependence. When  
the U. S. Interest Equalization Tax was adopted in 1963,  
the levy initially was made applicable, as you know, to  
Canada as well as to the rest of the world. It was promptly  
pointed out to U. S. officials that this artificial barrier

within a common financial market threatened to create impossible difficulties on both sides of the border. Accordingly, Canada was specifically exempted from the tax. This earlier lesson was not too well learned, however, for in January of last year the mandatory restraints placed on direct foreign investment by U. S. corporations was extended to Canada as well as to the rest of the world. Again, it was immediately necessary to exempt Canada.

Just as these and other U. S. efforts to strengthen the dollar and thereby the international monetary system have produced a certain amount of fallout with respect to Canadian-U. S. relations, by the same token it is well to recall the many advantages flowing to our and other countries from the system that was devised at Bretton Woods a quarter century ago.

World exports have climbed almost three times since 1950. Trade between the United States and Canada has grown even more remarkably, four and a half times. A broad and truly international money and capital market has developed for the first time in history. Confidence in the value of currencies has fostered one of the most exciting breakthroughs of our time: multi-national corporations that combine technology and resources for the most efficient production of goods throughout the world.

#### RECENT DIFFICULTIES IN THE INTERNATIONAL MONETARY SYSTEM

Against this background of progress, it has been

disturbing to see the international monetary system subjected to recurrent and severe strain these past fifteen months. If future growth in production, in trade and in financial flows is to continue at the rate of the past two decades, it is incumbent on us that we pursue the causes of recent events. As George Bernard Shaw opined, men are wise, not in proportion to their experience, but to their capacity for experience.

Has the system become accident-prone, as many analysts now claim?

It is clear, I think, that our recent time of troubles was not suddenly generated by sterling devaluation in November 1967. Difficulties had been building beneath the surface for some while; the shock wave of devaluation caused them to emerge.

The currency parities that were established at the time of Bretton Woods were not, of course, intended as eternal verities, handed down on tablets of stone. More than 200 changes in parities, some of them major, since then attest to the contrary. Some of these earlier currency realignments were disturbing at the time, but they did not shake the foundations of the system. In good part, this was due to the fact that during this period there was no question about the fundamental strength of the key currency, the dollar. True, the U. S. balance of payments has been in almost continuous deficit since 1949, but these deficits were not all of the same order of importance.

During most of the 1950s they were, as you know, a matter of conscious U. S. policy. Government capital exports under the Marshall Plan and other development plans were seen as beneficial, not only in rebuilding other economies but the reserves of the rest of the world as well.

On the other hand, our deficits in the sixties have clearly not been intentional. As a consequence, some \$8.6 billion of gold has been demanded from the United States in settlement of our cumulative \$20 billion deficit since 1959, and this despite efforts by our Government to convince other governments that they should refrain from presenting dollars for gold. By contrast, during the ten years, 1950-1959 inclusive, cumulative U. S. balance of payments deficits totalled more than \$17 billion, of which only \$5 billion were settled through gold transfers. Dollars were accumulated in foreign reserves during the 1950s, not because they were as good as gold, but because they seemed to their holders to be better than gold. Dollars have been presented for gold conversion in the 1960s because that view has no longer prevailed.

Consequently, when the problems that had been building beneath the surface were thrust into the open with sterling devaluation 15 months ago, they were imposed upon a monetary system whose key currency was not above reproach. There can be no question but that this plain and melancholy fact has contributed to the ensuing emergencies and persistent uneasiness in international monetary matters.

Weakened confidence in the dollar has been paralleled

by skepticism about many other currencies, helping to explain the interest by private investors in gold. In country after country, as the requirements for currency stability have come into conflict with the pressure for continuous full employment and rapid growth, the latter objective has been given priority. The inflationary result has been predictable, not unlike the fate of the skier who tried to take one ski around each side of the tree that suddenly loomed ahead.

Finally, some of the problems we have encountered lately have been due to the very success of the system. The reverse side of the many advantages flowing from the relatively new international money market, the growing internationalization of business and the large flows of private capital has been a vastly increased potential for the mobilization of funds to batter against a suspect currency. There was not, during the 1950s, an adequate supply of internationally held currencies, or the mechanism for generation of such a supply, to create a serious run against a major currency. That surely is no longer the case. As any currency today comes under question, the efforts of foreign traders to hedge themselves, of international creditors to reduce their exposure, and of speculators to profit from devaluation can bring prodigious pressure upon that currency.

THE PROBLEM: AN EPISODE OR SOMETHING MORE

The questions we must ask ourselves are these: Are the recent troubles only episodic and self-correcting or are

they evidence of deficiencies in the system? Is the system too brittle? Has it been unresponsive to the need for change and adaptation since its original formulation a quarter of a century ago?

Two important assumptions were implicit in the Bretton Woods agreements: first, that principal nations would regulate their economies so as to preserve the external values of their currencies in proper alignment with each other; second, that countries whose currencies worked their way into "fundamental disequilibrium" - i.e., got out of line with other currencies to an extent that domestic policies could not correct, - would thereupon proceed to change their currency values. How realistic have these two assumptions proved?

History's answers are not reassuring. Whether for better or worse, most Western countries since World War II have given the highest priority to economic growth and high employment, even at the cost of price inflation. It is not my function here today to judge whether this priority and the policies undertaken in support of it are always wise. Whether wise or not, it is an observable fact and one that must somehow be coped with by the international monetary mechanism. This rather dismaying conclusion is perhaps a little like that which automobile manufacturers must make about the attention and skill of drivers of the cars they produce.

Moreover, it is doubtful that fixed exchange parities could be maintained indefinitely even if all countries were

prepared to give the preservation of their currency values top priority. Individual countries experience differing rates of economic growth, of productivity change, and of price change because of the disparity in the world-wide allocation of resources and of technical capacity. It seems likely that, even if all of us had done a better job of managing our domestic economic affairs these past ten years, the relationships among currencies would only by accident be in balance today.

The second Bretton Woods assumption, namely that values of currencies in fundamental disequilibrium would be altered promptly, also has proved questionable. A decision to change a currency parity has proved a very difficult decision, indeed, for national governments. For a government that has been in power, devaluation is a confession of failure and can be politically disastrous. Even new governments, such as Mr. Wilson's in Britain in 1964, have elected to fight to preserve the existing parity. In our closely inter-related economic world, it seems a fair working hypothesis that currency realignments of major countries, even where reasonably indicated, will be difficult to make.

If national governments may not be expected at all times to play by the "rules of the game" envisioned at Bretton Woods, then we must look at the international monetary system in a somewhat different light. It becomes necessary to recognize that there may be flaws in the system itself for

which the best cooperative efforts of the principal nations will not fully compensate. To say this in no sense denigrates international cooperation in the maintenance of an efficient monetary system. The shocks to the system in the last year and a half would have been far greater were it not for the cooperative climate that has been so carefully nurtured. Whatever other adjustments might be undertaken, such cooperation is essential for the future. But even the most extensive system of currency swaps can not indefinitely patch over basic imbalances among important currencies growing out of persistent balance of payments surpluses or deficits.

#### AGENDA FOR CHANGE

It is such considerations as these that have led to various proposals to make the international monetary system more responsive to changing relative values of major currencies. A number of ideas have been advanced, ranging from fully flexible exchange rates to widening the band for exchange rate fluctuation, and including that rather remarkably named proposal, the "crawling peg" or sliding parity.

Fully flexible exchange rates would appear to have such harmful implications for international trade and capital movements as to rule the idea out of consideration. While it is false to suggest that the existing parities are, like the yardstick, immutable, neither is it realistic to regard the price of a nation's currency as no different from that of cocoa or pepper. Money, after all, does function as a medium

of exchange and a store of value. Moreover, it was probably not accidental that the founding fathers at Bretton Woods, on the basis of their hard-won experience, opted for a system of fixed and not floating exchange rates.

While a band for exchange rate fluctuation somewhat broader than the present one per cent might turn out to have few harmful consequences, it would not seem that such a band by itself would do anything to solve the problem of currencies gradually getting out of balance with one another. The so-called "crawling peg" with its capacity to effect small, gradual changes in currency parities has a certain intellectual attractiveness, but investigation of this proposal suggests that it may well be mechanically monstrous. The consequences of both the broader band and the "crawling peg" strike me as wholly unpredictable and I find myself a-man-from-Missouri about them.

These proposals for a simpler system of realigning currency values appear rooted in the desire for an automatic process that would not require conscious intervention by public officials. But is it necessary or promising to start down either of these uncertain roads? It occurs to me that a more promising, though far from simple, alternative is to search for agreement on ways and means of negotiating changes in currency parities from time to time as necessary. Perhaps this is the direction that offers the greatest chance for introducing more accommodation into the international monetary system. My hope is that ways can be found, within existing international

forums, to negotiate confidentially and impose quickly small adjustments in the value of important currencies from time to time, adjustments hopefully achieved before pressure upon the exchange market made them unavoidable. Movement in this direction need not abandon the advantages of the external discipline that fixed exchange rates impose upon nations. Like Governor Rasminsky of the Bank of Canada in his recent address to the Overseas Bankers Club in London, I believe it is vitally important that there should be an external discipline to encourage governments toward those policies that will maintain the value of their currencies. This discipline has been an important force toward responsible policies in all developed countries. Still, one cannot blink the fact that it is not always sufficient. Movement in the direction I have proposed would retain the essential discipline of the existing system while recognizing that it has not always provided the means for orderly change.

Another important item on the agenda for the future is a clear understanding of the role of gold in the international monetary system. If, as I expect and believe to be right, gold as the principal component of reserves will decline and if future reserve growth will largely take other forms, then there is no basis for increasing the present price of gold. In that case, the next important item on the agenda is prompt action with regard to the Special Drawing Rights under the IMF. International reserves must grow if we are to avoid more repressive

economic and international policies by countries battling to protect their reserves. Little gold will flow into reserves at the present official price, and successful efforts by the United States to strengthen the dollar will result in smaller additions to international currency reserves. To cover the deficiency we can look to S.D.R.s. It is now almost a year since the Group of Ten, meeting in Stockholm, approved the S.D.R. proposal. At the latest count only 33 members of the I.M.F. had ratified the amendment; 67 ratifications are necessary. It is important that this hopeful plan be ratified expeditiously, that issuance of S.D.R.s should begin promptly and in sufficient volume to offer some protection against future currency crises rooted in inadequate reserves.

Another approach to the adjustment problem that has occupied some attention recently is the use of border taxes as the Germans elected to do in place of upward revaluation of the mark last year. While there is much to be said for a value added tax as replacement for part of our own corporate income tax, use of such taxes as a substitute for currency realignment is a hazardous foray into the field of non-tariff obstacles to trade. It could lead to whetting of protectionist appetites.

There is a final agenda item that is not as easily identified as those already referred to but one that, over a span of years, may be the most important of all. This is the Three Musketeers principle -- "all for one and one for all".

It would appear likely that the private markets of the world will demand more dollars year by year, imposing a certain balance of payments deficit upon the United States which we should not attempt to resist. Meanwhile the U. S. reserve base of gold, S.D.R.s, and other currencies may not be able to grow at anything like the rate of growth of the claims on these reserves. If the payments system is not to become more vulnerable to crises of confidence, it will be essential that all the reserves of the industrial nations be available in support of the dollar, and that it be known that they are available. The clear corollary is that U. S. policies must justify that support.

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It is obviously not practical that we should revisit Bretton Woods in the sense of calling a full dress international conference to reorder the monetary system. That would be a mistake on virtually every count. But it is possible and indeed essential that we constantly renew the spirit of Bretton Woods. That spirit was rooted in a commitment that the disastrous events of the 1930s should never recur and was characterized by an open-minded willingness to consider any institutional arrangements that might promise to preserve international monetary order. We must recognize that what is at issue is the strengthening of a system that has worked very well indeed, in order that that system may be a support rather than a disturbance to continuing growth in trade and economic well-being around the world.

With the very best will, full international cooperation, and the application of the highest order of genius toward bringing the international monetary system into calm water, reasons for uneasiness about the durability of our solutions will remain. For example, no restructuring of the system could offer assurances of durable stability if the dollar is not above suspicion. The United States is currently moving to restore price stability. Return of the dollar to full strength and world confidence would provide the most important safeguard I can think of for containing within manageable proportions the disturbances of the kind that beset foreign exchange markets last year. That was clearly demonstrated during the emergency growing out of the French franc's weakness last fall.

It is too early to judge conclusively whether the U. S. stabilization effort will be successful, for it is the first attempt in my country to unwind a war-spawned inflation without a recession. So far the evidence is encouraging. A new Administration has taken office in Washington, staffed by excellent people in the sector that has concerned us today. Actions on the economic front in the opening weeks of the Nixon Administration have been auspicious, and there is good reason for confidence that the new team will continue to follow those policies that will steadily bring the U. S. economy onto the right course.

In time, wholly new international monetary arrangements may be devised, perhaps including the pooling of all reserves in the International Monetary Fund or the conversion of the IMF into an international central bank with the power of reserve creation. But all that is far in the future. Our immediate problems are rather easily identifiable and our immediate efforts should be directed toward them. We must study in depth the nature of the recent shocks to the international monetary system. We must determine whether there are structural deficiencies in the system that require amendment. We must commit ourselves to the proposition that no monetary system can be any healthier than the health of the principal national currencies which it serves. Proper understanding of our problems and cooperative willingness to develop solutions of those problems can move us forward on the road toward a freer, indissoluble international economy. Failure to act or acting imprudently could drive us further in the direction of shrivelling the exciting prospects that lie ahead. The stakes are high. The choice is clear. It remains only to get on with the job.