Origins of the Post-War Payments System

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Given the enormous significance of short-term capital movements in the post-war international financial system, it is noteworthy that the IMF Articles of Agreement paid little attention to them or indeed to private international capital transactions of any description.

'Members may exercise such controls as are necessary to regulate international capital movements', it is said in Section 3 of Article IV (Horsefield, 1969, p. 194). Section 1 of the same Article asserts that 'A member may not make net use of the Fund's resources to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund'. The IMF legislators prescribed that, 'If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund.'

This provision seems to contain the crude philosophy of the Bretton Woods agreements: capital flights are bad for the countries that experience them and these countries ought to control them if they want to use the Fund's resources.

However, lest the Article might be taken as being excessively interventionist, the latter part provides that 'no member may exercise these [capital] controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments' (Article VI, Section 3). Moreover, 'capital movements which are met out of a member's own resources of gold and foreign exchange' should not be affected by the aforementioned Articles, although 'members undertake that such capital movements will be in accordance with the purposes of the Fund' (Article VI, Section 1). The same Article also asserts that the Fund's resources will be available 'for capital transactions of reasonable amount required for the expansion of exports or in the ordinary course of trade, banking, or other business'.

Clearly, short-term capital movements were not regarded as an essential part of the adjustment mechanism foreseen by the Agreements; in fact, they were a nuisance, to be restricted rather than fostered. But all the burden of establishing controls was to fall on the countries from which capital flees and none on those to which it goes.

The original proposals of White and Keynes

Both the Keynes and White Plans had been much more exacting and explicit on the restriction of short-term capital movements. The White Plan was conceived as a highly co-operative effort to achieve equilibrium in international payments. It proposed quite <50> bluntly, that

Each country agrees (a) not to accept or permit deposits or investments from any member except with the permission of that country and (b) to make available to the government of any member country at its request all property in form of deposits, investments, securities, of the nationals of member countries, under such terms and conditions as will not impose an unreasonable burden on the country of whom the request is made (Horsefield, 1969, p. 66).

The explanatory remarks which Harry Dexter White appended to this proposal were even more definite about the need to get rid of short-term capital movements.

This is a far-reaching and important requirement. Its acceptance would go a long way toward solving one of the very troublesome problems in international economic relations, and would remove one of the most potent disturbing factors of monetary stability. Flights of capital, motivated either by prospect of speculative exchange gains, or desire to avoid inflation, or evade taxes or influence legislation, frequently take place especially during disturbed periods. Almost every country, at one time or another, exercises control over the inflow or outflow of investments, but without the co-operation of other countries such control is difficult, expensive and subject to considerable evasion ...

The search for speculative exchange gains or desire to evade the impact of new taxes or burdens of social legislation [he reiterated] have been one of the chief causes of foreign exchange disturbances. Less hectic and less dramatic yet in the case of some countries during some stages of their development capable in the long run of even greater harm, is the steady drain of capital from a country that needs the capital but is unable for one reason or another to offer sufficient monetary return to keep its capital at home. The assumption that capital serves a country best by flowing to countries which offer most attractive terms is valid only under circumstances that are not always present (Horsefield, 1969, pp. 66-67).

Thus White had no place for private capital flows in his blueprint. This is extraordinary, because the adjustment mechanism he envisaged was a sort of *dirigiste* Gold Standard. Since the real Gold Standard had relied on private short-term capital flows as an essential part of its adjustment mechanism, White was proposing to stage a production of Hamlet without the Prince of Denmark. However, he was convinced that it would be possible to enact a sort of 'nationalised Gold Standard' in which nations went through the paces of the classical mechanism without being prompted, or assisted by international short-term capital flows. In this triumph of the concept of the state as monopolistic regulator of international economic relations, White accepted that some social groups would be sacrificed.

Such an increase in the effectiveness of control means, however, less freedom for owners of liquid capital. It would constitute another restriction on the property rights of this 5 or 10% of persons in foreign countries who have enough wealth or income to keep or invest some of it abroad, but a restriction that presumably would be exercised in the interest of the people at least so far as the government is competent to judge that interest.

The inclusion of this provision does not mean that capital flows between foreign countries would disappear or even greatly subside; it means only that they would not be permitted to operate against what the government deemed to be the interests of any country (ibid., p. 67).

In Keynes's plan to reconstruct the international monetary system short-term capital movements had no role to play either.

It is widely held that control of capital movements, both inward and outward, should be a permanent feature of the post-war system --- at least so far as we [the British] are concerned. If control is to be effective, it probably involves the *machinery* of exchange control for *all* transactions, even though a general open licence is given to all remittances in respect of current trade. But such control will be more difficult to work, especially in the absence of postal censorship, by unilateral action than if movements of capital can be controlled *at both ends*. It would therefore be of great advantage if the United States and all other members of the Currency Union would adopt <51> machinery similar to that which we have now gone a long way towards perfecting in this country though this cannot be regarded as essential to the proposed Union.

This does not mean that the era of international investment should be brought to an end. On the contrary, the system contemplated should greatly facilitate the restoration of international credit for loan purposes. ... The object, and it is a vital object, is to have a means of distinguishing --- (a) between movements of floating funds and genuine new investment for developing the world's resources and (b) between movements, which will help to maintain equilibrium, from surplus countries to deficiency countries and speculative movements or flights out of deficiency countries or from one country to another (Horsefield, 1969, p. 13).

In Keynes' version the repudiation of short-term capital movements as a part of the adjustment mechanism was much more nuanc\'e and subtle than in White's. The distinction between virtuous and vicious capital flows was proposed and capital controls were seen as a necessary, though not particularly cherished, measure to be suffered by impoverished countries. Keynes saw control *at both ends* as a favour that surplus countries should do for deficit countries, although he nominally justified it in the name of efficiency. This was clearer in the second version of his plan, written almost a year later. There capital flows were considered bad, if induced by 'political reasons, or to evade domestic taxation, or in anticipation of the owner turning refugee' (ibid., p. 31). No mention was made of speculative flights or of arbitrage-induced flights. White's ringing condemnation of the latter was completely ignored by Keynes. So was White's \'etatiste philosophy. Keynes' second proposal simply stated that capital controls just *had to be* 'a permanent feature of the post-war system' and that they had to be exercised by both surplus and deficit countries simply because it was 'more difficult to work [them] by unilateral action on the part of those countries which cannot afford to dispense with [them]'. But he was well aware of the fact that 'those countries, which have for the time being no reason to fear, and may indeed welcome, outward capital movements, may be reluctant to impose this machinery', even though, he added reassuringly, 'a general permission for capital, as well as current, transactions, reduces it to being no more than a machinery of record' (p. 31).

Clearly, between 1942 and 1943, \'etatisme and control had gone out of fashion. Banking and financial interests, certainly in the US and very probably in Britain as well, had considered the earlier versions of both White's and Keynes' plans. Quite probably, White's reference to the need to sacrifice '5 to 10% of persons' had stuck in their throats.

For this reason, or for others, later 'IMF proposals' contained very watered-down formulae relating to capital controls. In the final version quoted earlier, 'bilateral' enforcement of capital controls had disappeared altogether. The denial of IMF assistance if a country experiencing a capital outflow failed to impose controls was a complete about-turn with respect to the earlier plans, which were based on the principle of co-operation between surplus and deficit countries in maintaining payments equilibrium. Short of the drastic scarce currency clause, nothing was foreseen which might put pressure on surplus countries.[1] <52>

The background of conflicting US and British interests

The IMF Charter bears witness to the gradual worsening of Anglo-American relations between 1942 and 1944. The Articles of Agreement are a far cry from the White Plan blueprint for intense international co-operation with a large measure of supranationalism. This had been designed to buy off British interests by proposing American financial assistance to Britain operated through the IMF, while Britain would be ridding herself of sterling balances and imperial preference and returning to multilateral trade and payments.

As we can see from the Keynes Plan, this offer was taken up by Britain. However it then became known that the sum the US authorities were prepared to pledge was infinitely smaller than the $25 billion which had first been suggested. The figure was scaled down to $2-3 billion and the US solution advanced for sterling balances turned out to have become one of making the owners of these balances shoulder the burden of their funding or even cancellation.

The US attempt to convert Britain to multilateralism in the monetary and trade fields was not accepted without protest by the British. There were lively reactions to all these proposals, even the most generous, emanating from the 'inner sanctum' of British finance, the Court of Directors of the Bank of England. Keynes was probably able to carry his country's authorities with him until the US side began to get cold feet and Harry White began to back down from his supernationalism and financial generosity.

The general picture Keynes and White had in mind for post-war monetary equilibrium had been very much influenced by a background of conflicting US and British interests. White because of his philosophical conviction, and Keynes because of his disillusioned realism about the state of the British economy, had agreed on a blueprint for the future in which multilateral trade and payments were to be re-established among nations in the form of a more-or-less 'nationalized', i.e. highly controlled system. They thought multilateralism would make a higher level of trade possible. But this did not mean unfettered *laissez-faire*, rather the opposite. The $25 billion supra-nationally managed stabilization fund was essential to this picture. Without it, or with only a fraction of it, Great Britain would be throwing away the well tried trading and currency system of the sterling area in exchange for nothing. The new trade and payments system would be justified, for a deficit country like Britain, only if her economy was to be helped to readjust by a large buttress of IMF loans.

These proposals would almost completely have bypassed the large financial institutions of the USA, in particular the New York banks. In the Keynes version the latter would have been excluded from the

Sterling Area. As they saw it, sterling convertibility was to be backed by American money while they were prevented from encroaching on the City of London's business.

It must be remembered that the New York financial community saw itself as the natural heir to the international role traditionally played by the City of London. The immediate post-war period seemed the appropriate time for the transfer of power to take place. The representations made by the New York financial community against the Keynes and White Plans were therefore numerous and powerful. The plans were accused of being inflationary and of requiring too much generosity on the part of the USA. Moreover American bankers, hit by the war-time cheap money policy, did not relish the prospect of this being continued in the future under the IMF. Their influence in Washington helped to secure the abandonment of the highly co-operative approach suggested by Keynes and White. <53>

The erosion of White's proposals was also assisted by the emergence of an increasingly powerful Dixiecrat lobby in the US Congress, which pressed for a return to *laissez-faire* in both internal and international US economic policy.

In order to see his creature, the IMF, delivered into the world, White transformed it beyond recognition, helped not a little by his British counterpart, who reacted to the new American mood by adopting the loss-minimisation tactic of seeking to maintain the *status quo* for as long as possible.

The movement back to a more decidedly *laissez-faire* system continued after the signing of the Bretton Woods Agreement. By subjecting US Directors of the IMF to the scrutiny of the newly established National Advisory Council on International Monetary Policy, by insisting that the IMF be located in Washington, and by several other measures, the US authorities proceeded to strip the institution of its supranational features, so that very soon it became a 'specialized branch of the US', as Peter Kenen was to call it thirty years later.

What is difficult to recapture today, when Britain is reduced to a GNP and share of world trade not much greater than Italy, is the importance of the Sterling Area and of the British Empire in the immediate post-war period. The US determination to do away with both seems hard to believe or to understand. It looks like a lot of fuss about relatively little. To understand the urgency of this determination we must again become convinced, as American businessmen, politicians, farmers and labour leaders were in the 1930s and 1940s, that the historic role of the USA was to replace the United Kingdom in its relations with the Sterling Area and the British Empire.

Even before the end of the war it had become clear that the defeat of the Axis powers would give the US an opportunity to take a large share of markets of the British Empire. With Latin America, these were the only markets that had remained largely untouched by war and which as a result offered an 'effective demand' for American exports.

Traditionally, since before the First World War, the United Kingdom had realised a surplus in imperial markets to spend on imports from the US and Europe. The remainder of the British Empire had realized a continuously large surplus with the US and spent it on imports from Britain. But during the war British industry had been allowed to concentrate on the war effort and Britain had accumulated a large deficit with the Empire in the form of sterling balances.

As a supplier of imperial markets, Britain had been replaced by the US, which had thereby transformed its pre-war deficit with the Empire into a large surplus.

It is easy to understand how the US dreaded the post-war reappearance of the UK as the traditional supplier of these markets. A return to the pre-war settlements pattern was to be prevented because US business had taken over, *vis-a-vis* the British Empire and Dominions, not only British visible trade but also, even more important, invisible trade. The US was therefore adamant in demanding an early termination of Sterling Area arrangements, especially the 'dollar pool', which had put at Britain's disposal the dollar receipts of the whole area.

One must not forget that in 1942-45 the European and Japanese economies were for all practical purposes written off. Only later on, in the new perspective of the Cold War, did they become important again. Until then foreign trade meant, to the UK and the US, trade between the Sterling Area and the dollar area. In the last years of the war nobody saw much hope of reorganising foreign trade on its traditional four pivots: the UK, the USA, Germany and Japan. On the part of some of the victors there was the <54> express desire *not* to see such a resurrection of pre-war patterns. Indeed these were the days when the 'Morgenthau Plan' was still official American policy.[2]

All this is recalled here in order to clarify why US policy, since the early days of the war, had been aimed at actively seeking the abolition of what US sources called the 'Sterling Bloc'. One cannot blame US politicians, business and labour leaders, whose most immediate pre-war experience had been the Depression and the slump in American exports, for trying with all their might to undermine a potentially authentic trade and payments bloc, the Sterling Area, where the US had sent 27% of its total exports before the war, and which contained what looked, at least for the immediate feature, the most promising and solvent markets for American manufactures and invisible exports. Because of the war the USA had experienced an increase in exports from $3 billion to $15 billion. Bearing these figures in mind one could not think in terms of post-war trade expansion. In foreign trade the US aim would naturally be that of holding on to its newly won share of the market. 'Multilateralisation' of the Sterling Area was essential to enable continuation of the US in its war-time role as supplier of food and manufactures to Overseas Sterling Area territories.

In view of these realities, the Keynes Plan stands out as a brave attempt to divert the focus of attention from the issues most dangerous for Britain. Keynes was painfully aware of the inherent weakness of the Sterling Area, of its fundamental inadequacy to stand united against US opposition to its existence. What US opinion considered a 'trading bloc' he knew to be an informal arrangement kept together by an array of diverse motives, the most valid of which had been, before the war, the unreliability induced by the depression of the US economy as an absorber of Sterling Area exports, and during the war, mobilisation against the German enemy. In February, 1942, he wrote:

The advantages of multilateral clearing are of particular importance to London. It is not too much to say that this is an essential condition of the continued maintenance of London as the banking centre of the Sterling Area. Under a system of bilateral agreements it would seem inevitable that the sterling area, in the form in which it has been historically developed and as it has been understood and accepted by the Dominions and India, must fall to pieces.

... If we try to make of the sterling area a compact currency union as against the rest of the world, we shall be putting a greater strain on arrangements, which have been essentially (even in time of war) informal, than they can be expected to bear ...

Is it not a delusion to suppose that the *de facto*, but somewhat flimsy and unsatisfactory, arrangements, which are carrying us through the war, on the basis that we do our best to find the other members of the area a limited amount of dollars provided that they lend us a very much larger sum in sterling, can be carried over into the peace and formalised into a working system based on a series of bilateral agreements with the rest of the world, accompanied by a strict control of capital movements outside the Area? (Horsefield, 1969, p. 10).

As Keynes explained:

It is possible to combine countries, some of which will be in a debtor and some in a creditor position, into a Currency Union which, substantially, covers the world. But, surely, it is impossible, unless they have a common banking and economic system also, to combine them into a Currency Union not with, but against, the world as a whole. If other members of the sterling area have a favourable balance against the world as a whole, they will lose nothing by keeping them in sterling, which will be interchangeable [in his Plan] with bancor and hence with any other currency, until they have occasion to use them. But if the sterling area is turned into a Currency Union, the mem- <55> bers in credit would have to make a forced and non-liquid loan of their favourable balances to the members in debit. ... They would have to impose import regulations and restraints on capital movements according as the area as a whole was in debit or credit, irrespective of their own positions. They would have to be bound by numerous bilateral agreements negotiated primarily ... in the interests of London. The sterling resource of creditor Dominions might come to be represented by nothing but blocked balances in a number of doubtfully solvent countries with whom it suited us to trade. Moreover, it is difficult to see how the system would work without a pooling of world reserves.

It is impossible that South Africa or India would accept such arrangements even if other Dominions were complying. We should soon find ourselves, therefore, linked up only with those constituents which were running at a debit, apart from the Crown Colonies, which perhaps, we could insist on keeping (ibid., p. 10).

If Keynes found it necessary to spell out to his compatriots the reasons why it would be impossible to keep the Sterling Area together as a Currency Union against the opposition (which really mean 'the sheer existence') of a dollar area unfettered by controls of any kind, American objectors could be excused for fearing that a considerable component of the British leadership was stirring towards transforming the Sterling Area exactly into what Keynes exposed as a dangerous chimera, a tight autarchic block.

'Contrary to occasional suggestion from British sources, these blocked sterling balances should most certainly be handled in the good old system of Dr Schacht. As we recall, he used blocked Reichsmark balances to force countries to buy from Germany by leaving them no other way of getting their money back.' Thus spoke Imre de Vegh at the annual meeting of the American Economic Association in February 1945. He was perfectly right: this was exactly the direction in which an important cluster of Labour economic advisers, Balogh and Schumacher prominent among them, had been moving. They had studied the success of Hitler's 'new economic order' and thought that it would be a good idea to reformulate the Sterling Area similarly.[3]

In view of the unanimous backing of American financial, industrial, farming and labour interests for a free trade (meaning free US exports), free payments, solution to world economic problems, as well as the new direction in British economic thinking just mentioned and the desire of the City of London to preserve the Sterling Area at all costs, one cannot be at all surprised by the progressive worsening of Anglo-American economic relations, as the conflict of interests become more and more explicit.[4]

Two tendencies became evident. On the American side the Bretton Woods Agreements began to be criticised because of what was seen as their extreme normative character. On the British side a rentrenchment began to take place, waiting for the American onslaught and trying to minimise the damage when it finally came.

The new US policy line

The theoretical background to the new US international economic policy line was excellent. It was largely due to J. H. Williams, the Harvard economist and Vice-President of the New York Federal Reserve Bank, who had been a long-standing and acute critic of orthodoxy in the fields of trade and monetary theory. In the Keynes and White Plans he recognised a starry-eyed normative exercise, the purpose of which was to establish a Gold Standard mechanism as the basis for post-war international economic relations. <56>

He strongly (and absolutely correctly) believed that the pre-1914 Gold Standard had been not the democratic interplay of countries regulated in their mutual exchanges by a Ricardian adjustment mechanism, but a hierarchical structure based 'around England as the central country'.

'Gold standard theory', he wrote, 'was based on the principle of interaction between homogeneous countries of approximately equal economic size. Gold standard practice in the 19th century operated not on this principle but on that of a common center with which the other countries were connected through trade and finance. But now that we have neither of these principles to work on the unequal size of countries presents problems with which the gold standard cannot cope' (Williams, 1944).

He was convinced that for the US there should never be any question of practicing exchange controls, or varying the dollar, in time of peace. Its foreign trade 'is secondary, as regards effects upon itself, and upon its home trade rest not only its chances for stability but fundamentally that of the others also'. England was in a different position: 'England clearly needs more latitude, but as a great international trade center and as a highly industrialised country whose well being depends predominantly on her foreign trade, she has an obligation, almost equal to our own, to maintain monetary stability and to practice the rules of multilateral trading --- an obligation which in a far-sighted view means as much to her as it does to those with whom she trades.' For these reasons he thought that monetary reconstruction must begin by settling the relations between the centre-countries. The main difference between his and the Keynes and White Plans' approach was in the conception of 'the importance of stabilising the truly international currencies whose behaviour dominates and determines what happens to all others'. Early post-war international co-operation in the monetary field should mainly consist in re-establishing a convertible sterling, which meant finding a stable dollar/sterling rate. Since Williams had categorically excluded revaluation of the dollar, it would be essential to devalue sterling.

In urging an early return to full sterling convertibility, Williams rang a clarion call that appealed to all shades of American opinion. The matter became more urgent as, in a mood of post-Bretton Woods disillusionment, Britain had begun in earnest to weave a Schachtian web of bilateral settlements, export promotion and import substitution in the Sterling Area. The new Labour government, whose accession to power had greatly surprised, even dismayed, the US government and leadership, seemed intent on proceeding to the construction of a Socialist Commonwealth. If this process were in any way to gain momentum, none of the solutions the US sought to enforce would be feasible.

The final showdown

The US government pre-empted British options by terminating lend-lease. As Keynes had feared, this destroyed the unreal equilibrium upon which the Sterling Area had rested up to then.

Suddenly deprived of US aid, the British economy was on its knees. It was easy for the US government to negotiate a financial agreement under which it would give the UK financial aid against a pledge to re-establish sterling convertibility within a year. It was, it is true, only current account convertibility that the British undertook to re-establish. But it was easy then, as it had been before, and has been since, to disguise capital account as current account transactions, especially in a financial system woven together as informally as the Sterling Area, whose legitimacy --- as Keynes correctly apprehended in <57> 1942 --- derived solely from the consent of its members. Once the date of the return to convertibility was fixed, the British monetary authorities tried to enhance the credibility of sterling by the measures they adopted in the intervening period. They gave more, rather than less, latitude to non-colonial members of the Sterling Area to exchange sterling into dollars, by increasing the transfer accounts. They in no way diminished the free circulation of capital within the Sterling Area. Generally speaking, they seemed interested in enlarging and loosening even more a system of payments that was already too loose to stand as trying a test as the return of its currency to external convertibility.

But the British authorities' main mistake was even to consider, let alone strive for, a return to sterling convertibility on the strength of purely current account considerations. They made the same mistake as in 1926; worse still, the British long-term creditor position had become much weaker because of the war, especially when compared with short-term sterling balances.

The long interval that elapsed between the Anglo-American financial agreement, when the pledge to return to convertibility was made, and July 1947, when it was supposed to be enforced, gave holders of sterling all the time they needed to assess the lack of realism of the enterprise, and to equip themselves in order to get out of sterling when it returned to convertibility. The existence of a 'cheap sterling' market in New York, where inconvertible sterling could be sold for dollars, helped to reveal the difference between the official and market parity. All Keynes' apprehensions seemed to come true: it was simply too difficult to keep the Sterling Area together (which required convertibility and free movement of capital within the area), keep sterling inconvertible into non-area currencies, keep the sterling/dollar rate at the pre-war parity, ignore the existence of a free market for sterling in New York (unfettered by US authorities), and, at the same time, declare a date in the near future for the return to convertibility.

Devaluation has generally had few supporters in Britain, especially since the war.[5] In the immediate post-war years so much of British trade was with the Sterling Area, where British exporters had an almost natural monopoly position, that they did not have much truly 'foreign' trade. It was thus logical for British exporters to ignore the potentially higher profits to be derived from devaluation. In addition one must note that British importers have just as traditionally had a natural interest in keeping sterling as highly valued as possible.

Since a 'Devaluation Party' could not be found among the exporters, pressure for devaluation had to come from other quarters. It was difficult to imagine Britain's capital exporters or invisible exporters asking for devaluation. But all these people were interested in a return to sterling convertibility, as this would re-establish London as an international financial centre. The return to convertibility, at the pre-war parity and with the assistance of the American loan, was therefore a prospect which a wide range of interested parties in Britain found palatable. Only so can we explain the conspicuous lack of doubt and criticism in the British press in the months preceding July 1947. Unfortunately non-British holders of sterling had very few reasons to find the return to convertibility at the pre-war rate credible enough to justify a decision on their part not to take advantage of it to get out of sterling. The extraordinary coincidence of elements we have indicated --- loose controls within <58> the Sterling Area, the wide use of sterling as an invoicing currency, its unrealistic parity with the dollar, which was loudly propagandised by the 'cheap sterling rate' in New York, and finally the existence of huge sterling balances whose holders were motivated neither by patriotism, nor by the expectation of future gain --- made it inevitable for the convertibility experiment to end in complete disaster. In the course of the few weeks that it lasted, a good part of the American loan was transferred to former holders of sterling who wanted to get out. It was, in other words, mostly transformed into non-British demand for American goods.

The convertibility experiment served to highlight the fact that it was just as important for sterling to have an exchange rate that maintained balance in the capital account as to have one that maintained balance in the current account. There were too many holders of sterling too anxious to get rid of it for the nominal limitation of convertibility to current account transactions to be effective. Too many bridges linked the dollar area, unfettered by restriction, to the sterling area where restriction was the rule.

European exchange controls in the 1930s had not prevented Europeans from sending extremely large funds to the US. As Alvin Hansen noted in 1945: 'It is also true that the abnormal gold flow into the US in the thirties was related not solely, or even mainly to a world disequilibrium in the current international account, but largely to capital movements. Thus, of the $16 billion gold inflow [1934-42], $6 billion may be attributable to an export surplus ... while the remaining $10 billion are attributable either to recorded capital inflow ($6 billion) or to unidentified transactions ($4 billion)' (Hansen, 1945).

It was keen awareness of the importance of this phenomenon that had led White and Keynes to suggest in their plans that 'control at both ends' ought to be mandatory if capital flows were to be prevented from distorting what they considered to be the legitimate adjustment mechanism, the one working through current accounts.

But 'controls at both ends' were excluded from the Articles of Agreement of the IMF. There was, as a result, ample scope left, in the post-war international monetary system, for the same pattern that had characterised the 1930s to reappear. Inevitably it did reappear, not only in the Sterling Area but for Europe in general. In the words of Robert Triffin (1957):

To the outside world, the most spectacular manifestation of this bankruptcy lay in the staggering $9 billion of foreign disinvestment, borrowings and grants, absorbed by Europe in 1947 in a desperate effort to maintain minimum levels of imports, consumption and investment. In the absence of foreign aid, such a deficit would have just about wiped out the total gold and dollar holdings of Europe ... This enormous deficit could not altogether be attributed to excessive import levels. In spite of urgent needs for consumption, restocking, and reconstruction of war-depleted and war-devastated economies, the volume of imports was held down to 1938 semi-depression levels. The $9 billion gross deficit of 1947 appears to be made up of:

(1) An exceptionally high level of capital exports and capital repayments ($2 billion).

(2) A decrease in the volume of exports.

(3) A worsening in the terms of trade.

Now, if we except the second item in Triffin's list, the first and the third both show that the real problem was a re-emergence of the pre-war pattern: the worsening in the terms of trade was certainly due to the US internal boom and early repeal of price controls, and to US producers making the most of their temporary monopoly position. It also reflected the widespread European practice of under-invoicing exports and over-invoicing imports, a time honoured vehicle for capital exports.

It was thus from capital accounts that the first post-war payments crisis developed. <59>

This is worth affirming with emphasis, as the myth of Europe's excess demand for imports is extremely well established. The '5 to 10% of persons', who Harry White knew would have been sacrificed by his 'controls at both ends' scheme, were left free to find a haven for their funds in Switzerland and the United

States. Since it was clear that the US would not impose inward controls on capital movements nor revalue its currency, it was easy for the '5 to 10% of persons' in Europe to find ways of exporting capital in defiance of national exchange controls. US foreign aid was thus, from the very beginning, mainly used to balance European capital exports to the United States. This pattern continued throughout the years of Marshall Aid, so much so that M. G. Hoffman, the distinguished *New York Times* correspondent, could estimate, in July 1953, that 'capital flight from Western Europe in the postwar period had much exceeded US Government foreign aid to that area during the same period' (quoted in Bloomfield, 1954).

The most important factor in capital account turbulence between 1947 and 1949 was the United States' increasing desire to extract exports from Marshall Aid countries by compelling them to devalue their currencies. The US government, not unlike its predecessors in international economic stabilization in the 1920s (especially the Governor of the Bank of England, Montagu Norman), believed that stabilization loans should be given to countries on condition that they undertook to deflate and devalue. This recipe had been suggested by Harry Dexter White in his plan and had been written into the Articles of Agreement of the IMF. The US government soon realised that the Marshall Plan, devised as an instrument to maximise American exports of food, raw materials and capital goods, and at the same time induce the reconstruction of Europe, did not provide enough incentive for European exports; rather the opposite was true.

The US authorities, as a result, turned to the more traditional Norman/IMF stabilisation recipe and began to preach deflation and devaluation to Marshall Aid receivers: 'The Council has given continual attention to the problem of the exchange rates of the participating countries', reported the National Advisory Council on International Monetary and Financial Problems on 5 July 1949.

It concluded that in 1948 a general devaluation of the European exchange rate was inadvisable in view of the possible internal repercussions of devaluation on the participating countries in a period when their economies still exhibited serious inflationary tendencies, while their levels of production were not adequate to maintain an expanded volume of international trade. In many of the participating countries these conditions no longer obtain, since substantial progress has been made toward recovery in their levels of production. The Council recognised that if viability of the European economies is to be attained by 1952 [when Marshall Aid was scheduled to end] greater progress must be made by the European countries in redressing their balance of payments position with respect to the Western hemisphere and in attracting private foreign investment. *It is Council's opinion that in some cases the devaluation of currencies may constitute means of bringing about the desired expansion of exports to the dollar area which, along with other appropriate measures, will contribute to more normal methods of financing after 1952*.

While fully aware of the difficulties involved in exchange rate adjustments, the Council believes that the problem should be explored with some of the European countries. When adjustments of exchange rates are indicated, it is expected that member countries will make appropriate proposals to the IMF (*Federal Reserve Bulletin*, September 1949).

Six months earlier, in their Annual Report for the year ending 30 April 1949, the executive directors of the IMF had proposed the same solution, deciding that 'where a price reduction ... is necessary to expand exports, it would in many cases seem possible only through an adjustment in the exchange rates'. The US government, acting both directly and through its 'specialized agency', the <60>IMF, was dictating a drastic change in exchange policy to its debtors, without the slightest regard to the fact that its public pronouncements would activate a gigantic capital outflow from the countries whose currencies it accused of being overvalued. The US authorities, in so doing, were making sure that devaluation, if it did not come voluntarily, would be *forced* upon reluctant governments by capital flight.

The US authorities had every reason to enlist the '5 to 10% of persons' in the various European countries to the cause of devaluation. European governments showed no particular inclination to devalue and every desire to solve their payments deficits by bilateral negotiations. They were of the opinion that not a small part of their troubles derived from the slump that had hit the US economy in 1948 and 1949, thus reducing US demand for imports and encouraging the US supply of exports. Chief propounder of this thesis was the UK government. Having identified the cause of the marked deterioration on the dollar position of the Sterling Area in the US slump, it announced, on 14 July 1949, a new austerity programme which would reduce UK imports from the US and Canada by $400 million in the course of the fiscal year.

This was a 25% reduction in UK dollar area imports. At the same time, Commonwealth governments announced equivalent plans to reduce their dollar imports.

It is easy to imagine the effect of these declarations on US business opinion. US businessmen had looked to exports as a safety valve in the current slump of the US economy. The UK had been able to enlist the support of the Commonwealth governments because the slump in US imports had hit them much harder than Britain, and the example of the Sterling Area could be imitated elsewhere. Multilateralism and convertibility, which the US had chosen as the main objectives of its international economic policy, might be postponed indefinitely by the new spate of import controls and bilateral deals induced by dollar famine.

Adopting the 'Williams model', the US authorities concentrated their efforts on Britain on the correct assumption that if she could be won to devaluation, everybody else would follow. In the summer of 1949, after the National Advisory Council and the IMF had encouraged owners of speculative funds to get out of European currencies, negotiations were held first in London and then in Washington, between the UK, the US and Canadian governments. As the UK remained adamant, the US threatened to cut Marshall Aid to Britain. By calling the UK's bluff, the US made sure that sterling would be devalued. Speculative forces set in motion by the earlier declarations of the IMF and the US government had already prepared this path.

On 18 September 1949, Britain devalued by 30%, followed by 25 countries. As Stafford Cripps declared, the huge devaluation was chosen with the explicit aim of discouraging further speculation. No 'current account' explanations were given by British authorities. Their 'elasticity pessimism' had been notorious since 1926 and constituted not a small part of the 'Treasury view'.

The adjustment mechanism proposed by the IMF was brought into action by capital account imbalances, induced by speculation, which made defence of the parity impossible.

But the savage devaluation forced upon Britain by the US and followed by all relevant countries also had momentous effects on the balance-of-payments current accounts of all members of the IMF for the next 25 years. The European economies were, by this drastic exchange-rate re-alignment, transformed into export economies. An 'exporters' lobby' of increasing importance came into existence in all European countries which prevented meaningful adjustments of European currencies until 1971. <. 61>

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Notes

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[1] That this was so did not go unnoticed at the time the IMF Charter was agreed upon. Joan Robinson for instance, remarked 'It is interesting to observe that article VI of the Bretton Woods Documents is drafted in such a way as to leave USA free from any inducement to control capital transfers ... It is symptomatic of the fact that the US authorities have no intention of exercising control over capital movements of any kind, so that the adjustment of new lending to the balance on income account is to be left as heretofore to the chances of *laissez faire*. Even if the "hot money" nuisance were kept within bounds by controls in the deficit countries, the major problem of international lending would still remain to be solved' (Robinson, 1944, p. 435 ff).

[2] There were, of course, exceptions: James Burnham, for instance (1941), predicted the integration of Britain into Europe, the loss of her Empire, and the emergence of three pivots of world trade and economic activity: Europe, the US and the Far East. Claude Guillebaud, on the other hand, had examined, as early as 1940, the need to create, after the war, a *Lebensraum* for Germany in Europe, not very different in scope from the Neue Ordnung.

[3] Not surprisingly, however, a basic agreement with these views was vocally expressed by traditional City and Tory quarters. The *Economist* and the *Financial Times* were the standardbearers of this opinion.

[4] A very balanced assessment of the basic conflict which existed between British and American post-war plans was made by Louis Rasminsky, in a paper presented at Harvard in March 1945 (Rasminsky, 1945).

[5] An exception was represented by D. H. Robertson, who in an address given at Chatham House on 21 June 1945 (Robertson, 1945), voiced a heterodox 'elasticity optimism'. But not even he gave any thought to the need to devalue for capital account considerations, i.e. to restore the pound to a parity more related to the ratio of assets to liabilities.