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Division of Research and Statistics
International Sections

REVIEW OF FOREIGN DEVELOPMENTS

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Measurement of the Increase in Bilateralism Between 1928 and 1935

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Betty Hinrichs

To what extent was world trade bilaterally balanced prior to the world depression? To what degree did bilateralism increase during the depression? If we confine our attention to commodity trade, it is possible to frame reasonably exact answers to both questions. It is of course somewhat arbitrary to restrict consideration to trade in commodities only, since service items are also of interest in this connection, but insufficient data are available to make possible the more ideal approach.

A simple and rather interesting method of attacking the foregoing questions is to imagine a situation in which each country balances trade bilaterally by simultaneously making the following decisions: (1) to maintain unchanged its level of imports from each country with which it has had a favorable trade balance, and (2) to reduce its imports (to the level of its exports) from each country with which it has had an unfavorable trade balance. In this situation, all countries would find their trade balanced on a bilateral basis; between any two countries, exports would equal imports, and would be at the lower of the two former magnitudes. For any given year, it is a simple matter to figure out how much trade would shrink if such decisions were to be made; all that is necessary is to compare the actual value of trade for the year in question with the value which would have obtained, had imports between any two countries been equal to exports at the lower of the two figures. The question can be answered not only for the world as a whole but for individual countries.

Of course, the more trade is bilaterally balanced at any given time, the less trade can shrink under these assumptions, so that it is an easy matter to determine whether trade is more nearly balanced bilaterally in one year than in another.

Fortunately, much of the work required for making such calculations has already been done by the League of Nations in its study, The Network of World Trade (1942). In this volume, imports and exports of all countries are broken down by countries of origin and destination, and are stated in dollars at annual-average exchange rates. Figures are available for three years--1928, 1935, and 1938. Of these years, 1928 and 1935 have here been chosen for comparison--the first year to represent the more or less "normal" situation preceding the depression and the latter year to represent the situation as affected by the world slump. Twenty-six countries are included in the study. These countries in 1928 accounted for approximately 86 per cent of international trade.

The results of this investigation are summarized in the ensuing table and accompanying charts. In the table, each country's imports from the other countries in the group are compared with the level of imports which would have prevailed had the countries balanced bilaterally in a downward direction. When the latter level of imports is expressed as a percentage of the former, an index of the degree of bilateral balance is obtained, in which a figure of 100 indicates complete balance. By this method, a figure is obtained for each country and for the group as a whole.

An examination of the table and charts reveals that most countries were characterized by a higher degree of bilateral balance in 1935 than in 1928. The most striking instance is the Soviet Union, which in 1928 was the least bilaterally balanced of the entire group, yet in 1935 was in almost complete balance. The Russian case, however, should not be taken too seriously, since in neither year did Russia account for as much as 1.5 per cent of international trade. In general, the countries which show a significant increase in bilateralism between the two years are countries of which such a change would have been expected. For example, it is hardly surprising to find that the trade of Germany, Denmark, Poland, and Argentina was more bilateral in 1935 than in 1928, and it would be most interesting to investigate the degree to which bilateralist tendencies in those countries were reinforced and extended during the later 'thirties.

From the figures in the table, it is possible to state how much the international trade of the group would have shrunk if all the countries had determined to balance bilaterally in the manner indicated. In 1928, trade would have diminished by 28.6 per cent; in 1935, by 26.1 per cent. Since the latter figure is smaller than the former, the international trade of the group as a whole was in a more balanced position bilaterally in 1935 than in 1928. But the estimated increase in bilateralism--an increase of 3.6 per cent--is less than might have been expected. The reason for this is that several of the countries in the group, including such important countries in international trade as France, the United Kingdom, and the United States, appear to have been less bilaterally balanced in 1935 than in 1928.

Summary of Data on Bilateralism
(Millions of dollars at annual-average exchange rates)

Country	1928 A: Actual Imports 1/	1928 B: Imports under Bilateral Assumption	1928 C: Degree of Bilateral Balance 2/	1935 D: Actual imports 1/	1935 E: Imports under Bilateral Assumption	1935 F: Degree of Bilateral Balance 3/	G: Percentage Change in Degree of Bilateralism between 1928 and 1935
Argentina	1,123	892	79%	279	242	87%	+ 9.1
Australia	977	646	66	323	226	70	+ 6.1
Austria	544	345	63	147	96	66	+ 3.3
Belgium	1,159	972	84	462	384	83	- 0.9
Brazil	620	452	73	186	163	87	+19.6
British Malaya	576	334	58	182	112	61	+ 5.8
Canada	1,961	1,376	70	504	444	88	+25.4
China	1,033	647	63	261	144	55	-12.1
Cuba	335	272	81	85	69	81	0.0
Czechoslovakia	754	637	84	201	179	89	+ 5.4
Denmark	665	353	53	240	182	76	+42.4
Egypt	310	249	80	120	95	79	- 1.5
France	2,413	1,828	76	811	547	67	-11.0
Germany	4,250	3,108	73	1,069	912	85	+16.7
India	1,463	1,164	80	452	418	92	+16.3
Italy	1,530	967	63	450	297	66	+ 4.3
Japan	1,655	1,170	71	563	412	73	+ 3.4
Netherlands	1,479	975	66	510	331	65	- 1.6
Netherlands Indies	770	699	91	240	198	82	- 9.1
Poland	538	353	66	130	100	77	+17.1
Soviet Union	653	343	53	154	142	92	+75.0
Spain	727	477	66	210	133	63	- 3.4
Sweden	654	464	71	307	239	78	+ 9.9
Switzerland	730	495	68	329	225	68	+ 0.6
United Kingdom	6,603	4,387	66	2,345	1,484	63	- 4.8
United States	5,509	4,249	77	1,591	1,212	76	- 1.3
Total	39,032	27,855	71	12,151	8,982	74	+ 3.6

1/ All import figures in this study are on an f.o.b. basis. Where, as in most cases, the original data were on a c.i.f. basis, a downward adjustment of 10 per cent was made to allow for cost of transport.

2/ B as a percentage of A.

3/ E as a percentage of D.

CHART I

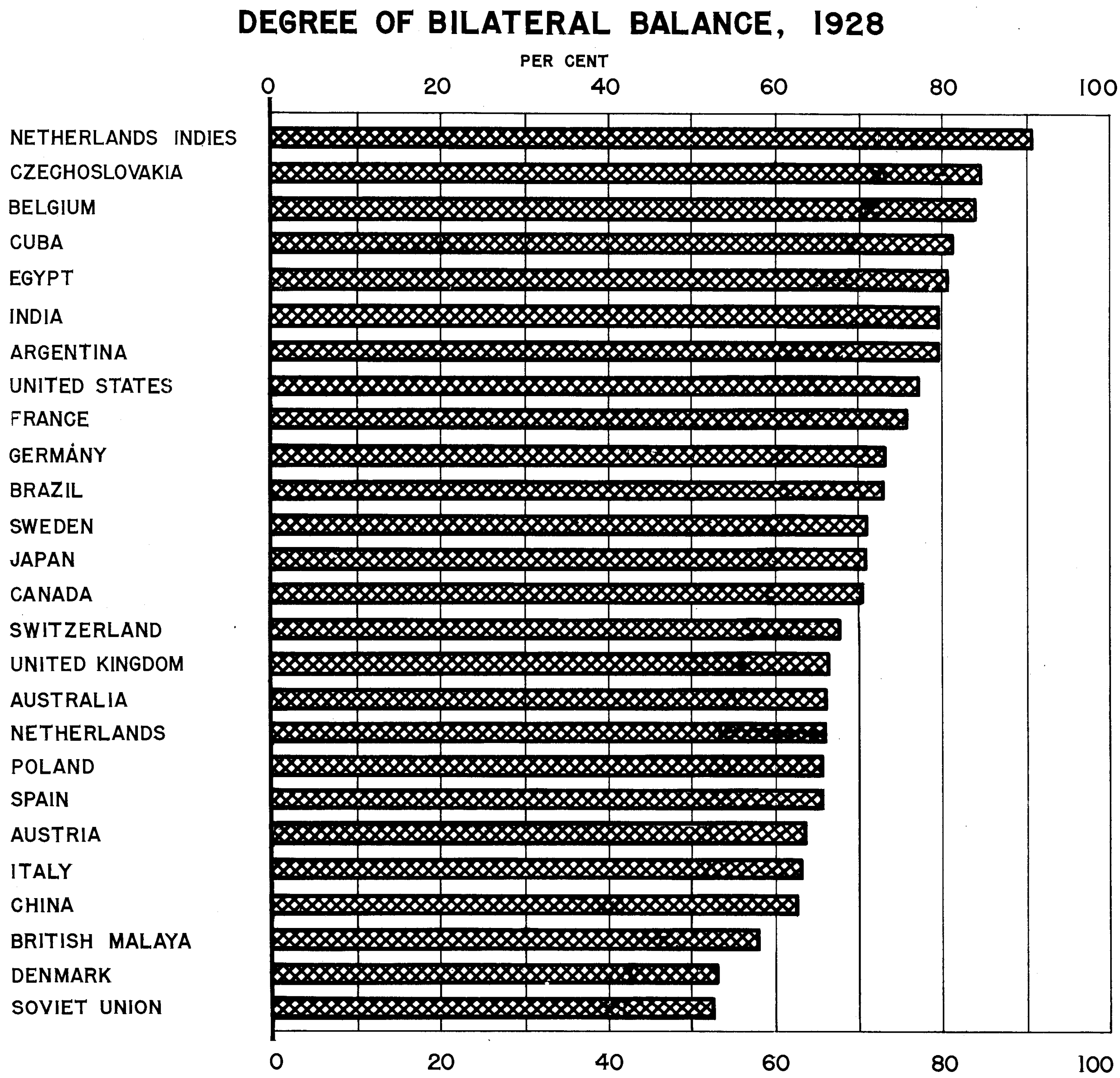

DEGREE OF BILATERAL BALANCE, 1928
PER CENT
0
20
40
60
80
100
NETHERLANDS INDIES
CZECHOSLOVAKIA
BELGIUM
CUBA
EGYPT
INDIA
ARGENTINA
UNITED STATES
FRANCE
GERMANY
BRAZIL
SWEDEN
JAPAN
CANADA
SWITZERLAND
UNITED KINGDOM
AUSTRALIA
NETHERLANDS
POLAND
SPAIN
AUSTRIA
ITALY
CHINA
BRITISH MALAYA
DENMARK
SOVIET UNION

CHART 2

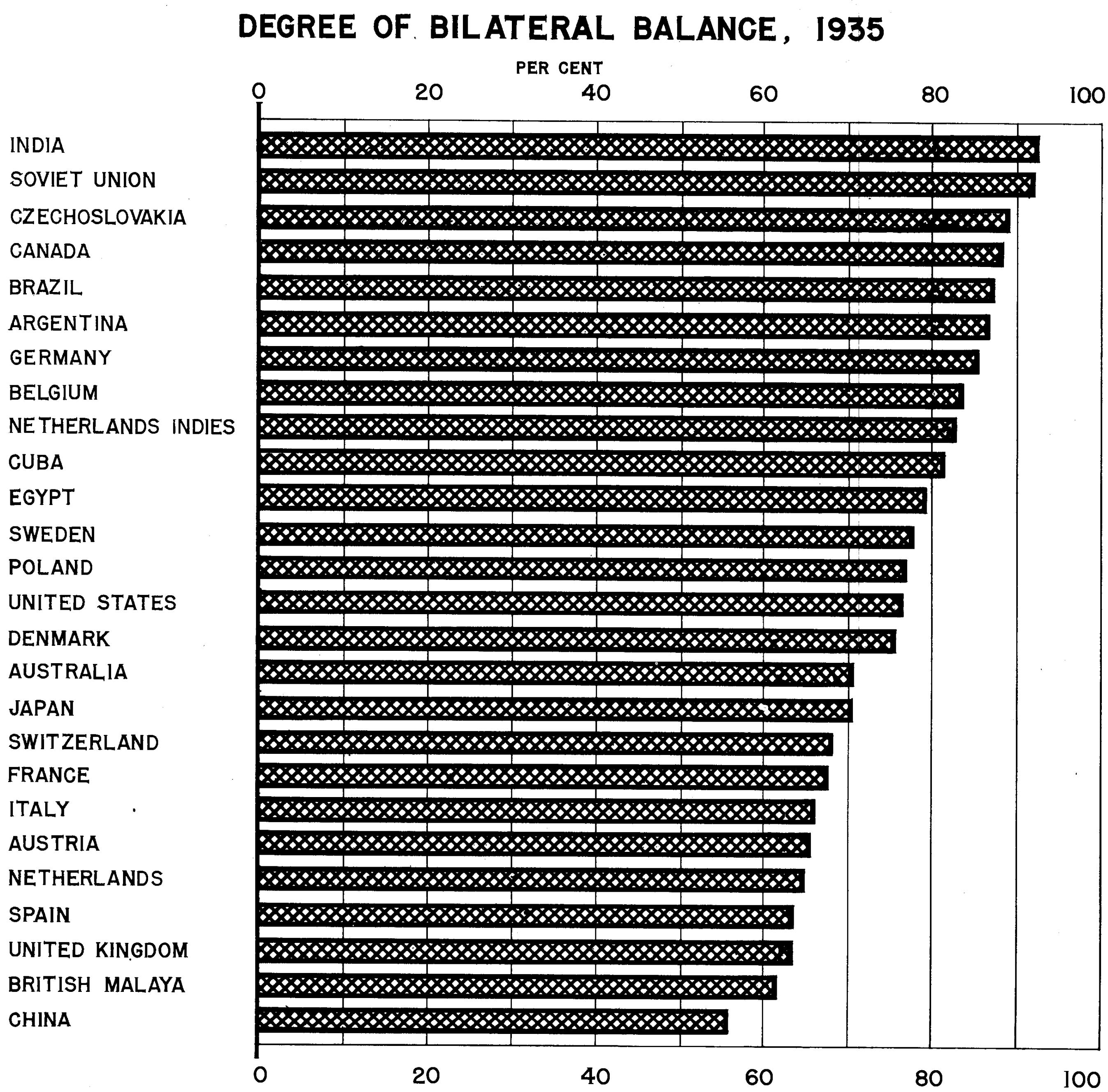
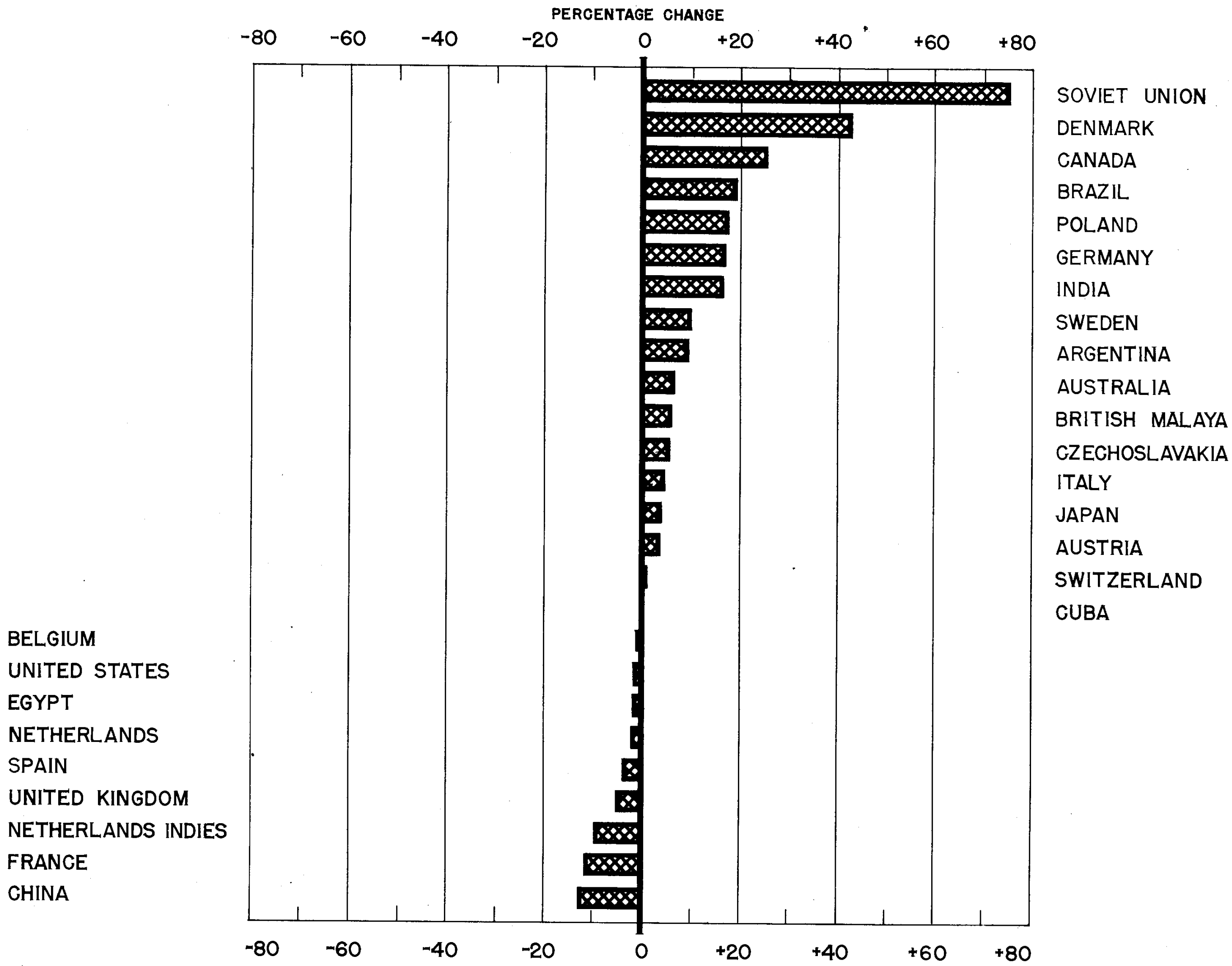

DEGREE OF BILATERAL BALANCE, 1935
PER CENT
0
20
40
60
80
100
INDIA
SOVIET UNION
CZECHOSLOVAKIA
CANADA
BRAZIL
ARGENTINA
GERMANY
BELGIUM
NETHERLANDS INDIES
CUBA
EGYPT
SWEDEN
POLAND
UNITED STATES
DENMARK
AUSTRALIA
JAPAN
SWITZERLAND
FRANCE
ITALY
AUSTRIA
NETHERLANDS
SPAIN
UNITED KINGDOM
BRITISH MALAYA
CHINA

CHART 3

CHANGE IN DEGREE OF BILATERAL BALANCE FROM 1928 TO 1935



Exchange Rates of Central European Currencies J.H.F.

The Hungarian National Bank has authorized credit institutions to quote interbank exchange rates for some currencies for which no official rates are quoted in Budapest, but which appear on the market from time to time . On the basis of these quotations and of the official dollar rate in Budapest, cross rates between these currencies and the dollar can be computed. In the following table, the cross rates are compared with the official and black market rates quoted in the countries of the respective currencies.

Central European Exchange Rates, May 1946
(United States cents per unit of local currency)

	Local official	Local black market	Budapest cross rate
Austrian schilling	10.0 1/	0.83 2/	1.59
Bulgarian lev	0.83	--	0.095
Czechoslovak crown	2.0	0.40 3/	1.67
German mark	10.0 1/	0.27 2/	0.77
Polish zloty	1.0	0.22 4/	0.49
Rumanian leu	0.005	0.0022	0.0025
Yugoslav dinar	2.0	0.39 5/	0.55

1/ Military rate. 2/ April. 3/ January.
4/ March. 5/ February.

The cross rates are of limited significance because of the small quantities of currencies traded. They are, however, better indications of a possible equilibrium rate than either local official or local black market quotations. Most official quotations are arbitrary and are often influenced by political considerations. Black market quotations are frequently subject to violent fluctuations for reasons associated with vagaries in official policies on black market repression, and are distorted because of the risk premium resulting from the illegal character of the market. The cross rates, on the other hand, reflect the judgment of shrewd specialists in markets comparatively free from official manipulation and devoting particular attention to foreign exchange problems because of the breakdown of their respective domestic currencies. In this respect they are comparable to the rates quoted in the tolerated free market at Istanbul which, during the war, provided valuable indications as to the standing of the currencies of the belligerent nations.1/ All of the cross rates show considerable discounts from official rates, ranging from 17 per cent for the Czechoslovak crown to 92 per cent for the German mark. All rates are, however, higher than local black market rates although part of the difference may be due to deviations in the dates of quotation. If the cross rates remain reasonably stable, they may be taken into consideration in evaluating the equilibrium level of exchange rates to be established under the Bretton Woods Agreements.

1/ See Review of Foreign Developments, June 11, 1945, p. 11.

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Exchange Practices and the Fund

Alice Bourneuf

Introduction

Members of the Fund have been subject to all their obligations under the Agreement since December 1945. Precisely what their obligations with respect to exchange practices will be in normal circumstances is not clear yet, however, partly because many are taking advantage of the special transitional arrangements permitting the maintenance and adaptation of war-time practices. It is important to analyse the exchange practices which appear to be permitted under the Fund Agreement in normal circumstances, without special Fund approval, and whether these are the most desirable exchange practices.

Will a member of the Fund be assured that other members will not normally be allowed to use exchange devices to limit current purchases from it? Is a member obligated, in normal circumstances, to allow the free exchange of its currency for others, provided its currency has been recently acquired by nonresidents as a result of current transactions or its own residents wish to obtain other currencies to make payments for current transactions? Will the exchange practices normally permitted under the Agreement enable members to use the proceeds of current exports to any one member to finance current purchases from other members?

Will the fact that members have access to the Fund affect their exchange policies? Will they adopt certain exchange practices because they wish to draw on the Fund rather than their reserves, or to accumulate reserves rather than Fund drawing privileges? Will certain currencies tend to be drawn from the Fund while the currencies of other countries are not drawn from the Fund even though those countries have a favorable balance on current account? Will the Fund itself adopt policies with respect to access to its resources by members which will affect their exchange practices?

Multilateralism versus Restrictions on Current Payments

It is often said that the Fund provides for a multilateral world, a world in which each country will normally be able to use the proceeds of current exports to any one member to finance current purchases from any other member. This is usually taken as equivalent to the statement that members must not impose exchange restrictions on current transactions, except with the approval of the Fund. But these statements are not equivalent.

According to the first statement, country A is protected against blocking by B of the proceeds of current exports to B; payments to A from B will be in some form which enables A to finance purchases from other members. If, for example, payments to A are made, in the first instance, in the currency of B, these currency holdings can be used by A to obtain the currency of any other member country.

This is of special importance to A if its exports to B exceed its imports from B. According to the second statement, on the other hand, country A is assured that the monetary authorities of B will not use exchange devices or restrictions to prevent residents of B from making payments to A for goods or services they wish to purchase in A. This assurance is something different and is of great importance to A. If payments to A are restricted and limited by the authorities of B, for example to a fixed amount, whether payment is made in the first instance in local or foreign currencies, the assurance of the first statement--that A can use the proceeds of exports to B to pay for goods purchased from other members--may be of relatively little value to A. It seems clear that the elimination of blocking does not necessarily imply the absence of restrictions on payments. It may also be argued that the elimination of restrictions on payments does not necessarily imply the absence of blocking.

General Clause Governing Restrictions on Payments and Transfers

The general clause in the Fund Agreement relating to exchange restrictions obligates members not to "impose restrictions on the making of payments and transfers for current international transactions."1/ The obligation not to impose restrictions on the making of payments presumably means that monetary authorities can not use exchange regulations or devices to prevent their residents from making payments freely to non-residents for current transactions. The right of any member to use other devices such as tariffs or quantitative restrictions on imports is not affected. It is difficult to draw the line between quantitative and exchange restrictions. Quantitative import restrictions, however, are usually considered to be restrictions imposed on the amount, not the value, of specific commodities which may be imported. A regulation providing that payments to a given country (or to all countries), for one commodity or for all commodities, may not exceed a given value in a given time period, whether in local currency or in foreign currency, is usually considered to be an exchange restriction.2/

1/ Fund Agreement, Article VIII, Section 2.

2/ As far as invisible items are concerned such as tourist, freight or insurance services, or gifts, it is difficult to imagine the imposition of quantitative restrictions. Any limitation on the use of such foreign services or the making of gifts would presumably restrict payments for such items. It would be in value terms normally and would be considered as an exchange restriction rather than a quantitative restriction. The regulation probably would not prohibit travel abroad as such or the transport of goods in foreign vessels, but would prohibit paying more than a certain amount for such services. Quantitative restrictions on imports, on the other hand, actually forbid the physical importation of the goods beyond certain amounts. Any person who proves he has been licensed to import the goods can not be prevented by quantitative restrictions from paying for them.

It may be argued that the obligation not to restrict payments would be met if country B did not restrict payments to other countries in B's currency for current transactions, irrespective of any restrictions imposed by B on the use other countries could make of balances of B's currency so acquired by them. The obligation not to restrict transfers, however, clearly implies something more. If residents of B make payments to residents of A in the first instance in B's currency, for example, B presumably can not prevent residents of A from transferring such sums into some other currency. But into what currency must B allow residents of A to convert these holdings? Or if residents of A request payment in the first instance in A's currency or in dollars, which involves a transfer as well as a payment, must B allow its residents to procure such currencies freely? Does the Fund obligate members normally to permit free exchange markets for the proceeds of current transactions? The answers to these questions may determine whether the Fund provides for a multilateral world. Restrictions on transfers may be no more important than restrictions on payments but the implications of the elimination of transfer restrictions are less clearly understood and will be considered almost exclusively in this paper.

The Convertibility Provision - Free Exchange Markets?

If balances of B's currency acquired by A as a result of current exports to B are to enable her to pay for current purchases from any other country, it may be argued that the balances must be freely convertible into the currencies of other countries in the market. Analysis of one of the provisions of the Fund Agreement suggests, however, that members are not obligated to permit free exchange markets.

The provision which suggests that free convertibility of currencies in the sense of free exchange markets is not assured is the "convertibility provision."1/ This provision obligates the monetary authorities of any member country B to purchase, from the monetary authorities of any other member country A, balances of B's currency recently acquired by A as a result of current transactions, if these balances are needed by A to make payments for current transactions. Country B has the option of buying the balances of B's currency from A either with gold or with A's currency. There are a number of conditions under which B is not obligated to make such purchases. In particular, B is not so obligated if restrictions on current payments and transfers have been imposed by B in conformity with the Fund Agreement, or if B is ineligible or unable for any reason to purchase currencies from the Fund, or if A's currency is scarce in the Fund.

If all members were obligated under other provisions to permit free exchange transactions in their markets, as far as the proceeds of current transactions are concerned, this convertibility provision would appear to be unnecessary. Country A could sell balances of B's currency

1/ Fund Agreement, Article VIII, Section 4.

in B's markets for any other currency.1/ Since the convertibility provision must be consistent with other clauses of the Agreement, there must be no obligation under other clauses of the Agreement to permit free exchange markets for the proceeds of current transactions.2/ If the general obligation not to restrict transfers does not require members to permit free exchange markets, what does it require?

The Repatriation Principle

The "convertibility provision," which assures A that, under certain conditions, it can convert balances of B's currency, recently acquired as a result of current transactions, into its own currency, really assures A that it can be paid for its current exports to B in its own currency. It may be described as assuring A the right to repatriate the proceeds of its exports. Is this same repatriation principle implied in the general clause prohibiting restrictions on "payments and transfers for current transactions"? As mentioned above, the word "transfers" implies that A must be able to receive payment from B in something other than B's currency. Since a member which is able to draw on the Fund is only obligated, under the convertibility provision, to permit payments to another country in that country's currency, it seems clear that the general clause, which applies whether or not a member is able to draw on the Fund, does not obligate a member to do more. The general clause, then, may be assumed to incorporate the repatriation principle.

1/ Country A would be protected against any substantial exchange loss because of B's obligation to maintain the rates of exchange within its territory between its currency and other member currencies within the prescribed margin of par.

2/ It has also been argued that, aside from the implications of the convertibility provision, members have the positive right to prevent sales of their own currencies, acquired as a result of current transactions, for the currencies of third countries, because such sales might in any case involve a capital transfer. This position seems to rest on a strained interpretation of the Fund Agreement. There is of course a possibility that such exchange transactions might involve capital transfers between the two other countries. Since the Fund does not specify that restrictions on capital transfers can only be applied by a given country in the case of capital movements between it and other countries, a member could perhaps refuse to permit such exchange transactions on these grounds. But the principal purpose of permitting restrictions on capital transfers was presumably to allow a country to restrict capital movements between it and other countries; refusal to permit exchange transactions because they might involve capital transfers between two other countries would seem to be unwarranted.
Each member can obviously supervise and license every payment to a nonresident and every exchange transaction because it is only with such complete supervision that it can exercise its right to control capital transfers. A member may have a government monopoly of all exchange transactions as long as no limitations or restrictions are actually imposed on payments to nonresidents for current transactions, whether in foreign or home currencies.

Whereas the general clause, then, implies that A must be able to convert balances of B's currency, recently acquired as a result of current transactions, into balances of A's currency, at any time that B is not imposing restrictions with the approval of the Fund, the convertibility provision only assures the monetary authorities of A that they can do so under certain conditions. It seems clear, therefore, that the convertibility provision does not impose an additional obligation on member countries. It indicates, however, that the general obligation of members not to restrict transfers is limited to what is involved in the repatriation principle and does not require them to permit free exchange markets. The convertibility provision, which applies only to monetary authorities, also shows how the monetary authorities of A can make sure that B is living up to its general obligation under certain conditions.1/

Repatriation Principle and Multilateralism

If the right of repatriation of the proceeds of current transactions (rather than free convertibility in the market) is what is guaranteed to members normally under the Fund Agreement, it is important to consider whether this right to be paid in its own currency will normally enable a member to use the proceeds of current exports to one country to finance purchases from other countries.

Assume that country A has an excess of exports to B paid for in the first instance in B's currency and that B will not permit the sale of B's currency in the market for other currencies. If the monetary authorities of A take over the balances they can require B to convert them into A's currency. Will this enable A to finance purchases from other countries? The problem is essentially the same if B refuses to allow its residents to make payments to A in the first instance in any currency other than A's.

Whether or not an excess of exports to B for which payment is made in A's currency will enable A to finance purchases from other countries depends on how B obtains A's currency to make the payment. Consider first the case in which B purchases A's currency outside the Fund and then the case in which B purchases A's currency from the Fund.

1/ Since the convertibility provision does not impose an additional obligation on members, it is difficult to see why it was included in the Agreement. It is even more difficult to understand why, in this provision, a member's obligation to purchase holdings of its currency from another member ceases when the member is for any reason unable to purchase currencies from the Fund. The explanation may be that the convertibility provision was proposed as an alternative to the general clause. The idea perhaps was that members should agree to eliminate restrictions on payments and transfers as long as they were able to get assistance from the Fund but should not agree to do so if the alternative was to use other measures to restore balance or draw on their reserves. What was originally proposed as an alternative may have been retained merely because it spelled out the repatriation principle. But this might better have been done in the general clause.

If B makes payment to A in A's currency purchased outside the Fund in the exchange market, country A can be assured that her excess exports to B are enabling her to finance current purchases from other countries, provided that she restricts the export of capital. Whether B purchases A's currency with her own currency or with foreign currencies, it is clear that either residents of A want the currency offered in exchange to make current payments or residents of other countries have balances of A's currency recently acquired as a result of current transactions which they wish to transfer into their own or other currencies. Country B's payments to A in A's currency then enable A to finance current payments to B or to other countries. There are abnormal cases, e.g. that of a scarce currency, when payments by A to some particular country could not be financed in this way but to the extent that A is paid in her own currency purchased in the market she can be assured that she is thereby being enabled to finance current purchases from some other countries.1/

If country A receives payment for an excess of exports to B in her own currency purchased from the Fund, the normal result is that A's drawing privileges are automatically increased by the amount of the decrease in the Fund's holdings of A's currency; A can normally purchase that much more in foreign currencies from the Fund.2/ Therefore, country A's excess of exports to B will enable A to finance current purchases from other countries.

In the abnormal case of a scarce currency, A may not be able to finance purchases from the scarce currency country.3/ There are two less abnormal cases in which A may not be enabled to finance purchases from other countries if A receives payment from B in her own currency purchased from the Fund. If A has been using the Fund in a manner contrary to the purposes of the Fund, or has failed to fulfill

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1/ If there is a scarce currency, or if country A cannot make payments to certain other countries in the first instance in its own currency, payments to it from B in its own currency will not finance purchases from such countries. Balances of A's currency will not be held by such countries. But if A's net imports do not put balances of A's currency on the market, country B will find that it has to purchase A's currency from A with freely usable foreign currencies or with gold.

2/ The quantitative limits on A's purchases of foreign currencies from the Fund are based on the net increase in the Fund's holdings of A's currency.

3/ The convertibility provision, or repatriation principle, gives added protection to a country amply supplied with the scarce currency. If B had a larger supply of the scarce currency than was currently demanded by her residents, it is not clear that she could limit its use to meeting the demands of her own residents under the terms of the scarce currency provision although this was probably what the drafters of the provision had in mind. Country B could, however, take advantage of her right to prevent free exchange dealings, as implied in the convertibility provision, and insist on converting balances of B's currency held by A into A's currency through the Fund rather than allow A to purchase the scarce currency with B's currency.

any of its obligations under the Fund Agreement, A's use of the Fund may be limited or A may have been declared ineligible to use the Fund.1/ Or conditions in A at the time may be such that irrespective of any previous relations between country A and the Fund use of the Fund by A would not be in accordance with the purposes of the Fund. Country A, for example, may be permitting a large or sustained outflow of capital, or have a chronic balance of payments deficit due to domestic inflationary developments. In such cases payment for A's excess of exports to B in A's currency purchased from the Fund presumably will not enable A to finance current purchases from other countries. Country A may be forced instead to reduce her indebtedness to the Fund or to increase her future drawing privileges.2/

Reasons for Invoking the Repatriation Principle

But why should B invoke the repatriation principle? Why should B prevent sales of its currency for third currencies or refuse to allow its residents to make payments to A in third currencies? Some of the possible reasons may be explored. Although B may wish to meet its deficit with A by drawing on the Fund rather than by using its own reserves, it need not insist on payments to A being made in A's currency if it can obtain any currency from the Fund to meet its deficit with A.3/ Of course, in the abnormal case of a scarce currency, B may not be willing to make payments to A in the scarce currency because sales of the scarce currency by the Fund are limited.4/

1/ Fund Agreement, Article V, Section 5.

2/ In these cases the Fund might take the position that, irrespective of A's inability to use the Fund, A could replace amounts of its currency currently drawn from the Fund by other members. The Fund might decide that, while A should not increase its net use of the resources of the Fund, or its net borrowing from the Fund, under such circumstances, it should not be forced to use the proceeds of its current exports to repay past borrowings. But there is no reference to net use of the Fund in the clauses relating to ineligibility to use the Fund. And the general clause relating to access to the Fund implies that a member has no right to purchase currencies from the Fund if it has been declared ineligible to use the Fund. It is not likely, therefore, that the Fund will interpret the ineligibility clauses in this way.

3/ It is reasonable to assume that the Fund will normally be willing to provide B with any currency, rather than to provide only such amounts of the currency of a given country as may be necessary to meet B's deficit with that country. If the Fund insisted on a bilateral policy, members would tend to invoke the repatriation principle because they might not otherwise be able to meet the actual pressures in their exchange markets by drawing on the Fund.

4/ In this case B might be glad to insist on its rights to pay in A's currency since it might otherwise be forced to use its own dollar reserves to support the dollar rate. This could be the case if B had more than enough dollars to meet current demands of its residents for dollars.

Is it possible that B would invoke the repatriation principle if B had previously accumulated balances of A's currency which it would like to use to meet its deficit with A rather than draw on its gold or reserves of other currencies? This implies that B considers certain currencies more desirable than A's currency, either because their future convertibility into other currencies seems more certain or because there is some reason to think they may become scarce in the future. At first glance this would seem to be less abnormal than the scarce currency case. If country A is not restricting capital exports, however, it would seem likely that country B might as well convert its balances of A's currency into some other currency rather than make a special effort over a long period of time to use them to make payments to A. If country A is restricting all capital exports, it may block completely the use of such previously accumulated balances. Country B will then not be able to use them even to finance current purchases in A. There is a third possibility. Country A might allow B to use the accumulated balances only for current purchases in A. In this case country B might insist on making payment to A in her own currency in order to use the accumulated balances of her currency. This is an abnormal case, however, because A would have no reason to allow the use of previously accumulated balances of its currency for current purchases in A and not for other purposes unless B was imposing discriminatory exchange or quantitative restrictions on current purchases, so that B's purchases in A would be increased as a result of A's discriminatory capital controls. If B's purchases were not increased A might as well allow B to use the previously accumulated balances for any purpose, since A's current ability to buy abroad would be reduced in any case below what it might otherwise have been to the extent that B used the balances to finance current purchases from A.1/

In summary, then, the cases in which B might invoke the repatriation principle are (1) the scarce currency case, and (2) the case of discriminatory restrictions on capital transfers which are adopted as a result of, or in order to encourage, discriminatory restrictions on current transactions by other countries. These cases are equally, or more, abnormal than those in which the repatriation principle would not enable A to finance its trade on a fully multilateral basis. The repatriation principle, as spelled out in the convertibility provision, may have been introduced in the Fund Agreement only to take care of such abnormal cases. If this is so, there is little reason to expect member countries, in normal circumstances, to take advantage of their implied right at any time to prevent free sales of their currencies, recently acquired as a result of current transactions, for other currencies, or to prevent their residents from making payments abroad in any currency they wish.

1/ Country B might invoke the repatriation principle if it were ineligible to use the Fund and if it expected A to invoke the repatriation principle. Country B might insist on its right to pay in A's currency if it had balances of A's currency, recently acquired as a result of current transactions, and expected A to insist on its right to convert them into B's currency purchased from the Fund. If B were ineligible to use the Fund, for other than quantitative reasons, it would then find that its exports to A were reducing its indebtedness to the Fund, or increasing its future drawing rights on the Fund, rather than enabling it to finance current imports. But in this case some abnormal situation must exist to lead country A to invoke the repatriation principle.

But the conclusion that there is no reason for members to invoke the repatriation principle to ensure their ability to meet deficits through the Fund was based on the assumption that a member can obtain the currency of any country from the Fund as easily as another, irrespective of whether its transactions with that country are unbalanced or not. This assumption must be reconsidered.

The Repatriation Principle and a Bilateral Fund

Reference has been made to the fact that member countries may wish to draw on the Fund rather than use their reserves, and to accumulate reserves rather than Fund drawing privileges. It has been assumed that these considerations might lead members to invoke the repatriation principle only in abnormal cases. However, the repatriation principle might be invoked generally if, contrary to the assumption made thus far, the Fund was willing to provide the currency of country A to country B only up to the amount of B's current deficit with A. In this case the Fund might be said to follow a bilateral policy in its dealings with members. The possibility that the Fund might adopt this bilateral policy is worth considering. It might do so if certain currencies were tending to become scarce in the Fund while some members were accumulating balances of these currencies and the currencies of other countries were not being drawn from the Fund even though they had a favorable current balance. It has been suggested that this will happen because members will consider drawing privileges on the Fund less valuable to them than reserves of gold or strong currencies. As a result they might try to use the Fund rather than their reserves to meet deficits and accumulate reserves rather than Fund drawing privileges when they have a favorable balance.

Fund Privileges versus Reserves

The inferiority of Fund drawing privileges as compared to reserves is commonly said to result from the possibility that dollars may become scarce in the Fund. Even if this were not a possibility, however, Fund privileges should not be regarded as equivalent to reserves. In the first place, members can use only a certain amount of their drawing privileges each year without special permission. Also, there are a number of specific purposes for which the Fund may not be used according to the Articles of Agreement. Even more important, borrowing from the Fund must be in accordance with the general purposes of the Fund. Members are expected to borrow for short periods to give them time in which to take measures to balance their international transactions. Finally, a member country may fail to fulfill some of its obligations under the Fund Agreement, for example with respect to exchange rates or exchange controls, and be declared ineligible to use the Fund. This is an extreme possibility, but under such circumstances there may be an extended period of time before a member is declared eligible again or before a member is able to withdraw its subscription to the Fund. During such a period Fund drawing privileges are obviously of no use.

Any country, on the other hand, is free to use its own gold and dollar reserves for any purpose. It may use reserves to meet an outflow of capital, to finance long-term reconstruction needs, or to pay war debts. Also, it may use gold to meet a deficit which gives evidence of becoming chronic without taking measures to correct the situation. For example, a country experiencing a rapid inflation may use reserves to meet the deficit which results. The Fund could refuse assistance unless drastic steps were being taken to stop the inflation.

Although there is a chance that dollars may become "scarce" in the Fund, this possibility is much less than is ordinarily supposed, at least on the basis of present membership in the Fund. The Fund will begin operations with gold, United States dollars, and Canadian dollars equal to 76 per cent of the normal borrowing privileges of all members other than the United States and Canada. Furthermore, the United Kingdom has indicated that it is not likely to use its drawing rights in the Fund which means that the percentage of gold, United States dollars, and Canadian dollars to the total drawing rights which will probably be exercised may be much higher. In addition, the repurchase and gold sale provisions will tend to replace the Fund's holdings of dollars and gold. Undoubtedly, however, the possibility that the dollar may become scarce in the Fund is an added reason why the monetary authorities of most countries will consider drawing rights on the Fund as less valuable or desirable than gold or dollar reserves.

Use of the Fund rather than Reserves

It is suggested that because of the preference for gold and dollar reserves as compared to Fund drawing rights member countries will rush to use the Fund rather than their own reserves in meeting such deficits as do occur. This in turn would increase the possibility of dollars becoming scarce in the Fund. The implication is that members have a clear alternative and are quite free to use one or the other as they see fit. Actually, one of the repurchase provisions requires all members which have reserves in excess of their quotas to draw on their reserves at the same rate year by year that they borrow from the Fund. Since countries with 83 per cent of Fund quotas or borrowing privileges have reserves in excess of their quotas and countries with 36 per cent have reserves more than twice their quotas, most of the borrowing from the Fund for some time to come will have to be accompanied by equivalent use of reserves by the borrowing country. Most members, then, will not be in a position to use the Fund rather than their own reserves.

The other possibility is that members might rush to use the Fund, pari passu with their reserves, by permitting deficits of a size they would not otherwise permit. It is true that the monetary authorities of an individual member country may adopt policies which lead to large deficits knowing that they will be able for a time at least to meet half the deficit through the Fund. But if the policies of the member country may be expected to result in a continuation of this deficit, the Fund must discuss with the country other means of meeting or eliminating the deficit. Member countries will not be allowed to use the Fund for unsound purposes, i.e., to meet deficits which give evidence of becoming chronic while taking no steps to overcome the deficit. Whenever Fund resources are used, the Fund must insist they are intended to be used on a temporary basis and, therefore, must insist on speedy repayment or elimination of indebtedness to the Fund. The Fund can only continue to be of use in any case if it is a revolving fund. If the Fund insists in general on prompt repayment, there remains little reason why a country should rush to use its Fund privileges since it will shortly have to use reserves to repay the Fund. On the whole, therefore, there is no great danger in the situation brought about by the coexistence of Fund drawing privileges and gold reserves from the point of view of leading to rash or speedy use of the Fund in preference to or pari passu with the use of gold reserves.

Accumulation of Reserves rather than Fund Privileges

In spite of all the safeguards, weak management of the Fund and shortsighted policies on the part of member countries might lead to a scarcity of dollars in the Fund. Is there a likelihood that the scarcity of dollars would be partly due to the fact that the currencies of other countries were not being drawn from the Fund even though they had favorable current balances?

Member countries may make efforts to accumulate reserves rather than drawing rights on the Fund. First, if a member is ineligible to use the Fund for any reason, or if some currency has been declared "scarce," it may be anxious to receive payment outside the Fund whether its current transactions are balanced or not. Second, even if a member is eligible to use the Fund, it may wish to accumulate reserves rather than Fund drawing rights. If a member does not have a favorable balance on the whole, it can not get paid in gold or dollars for its exports and at the same time pay for its imports through the Fund. In such circumstances the repurchase provisions would require it to use the increase in its gold or dollars to pay back the Fund at the end of the year. Therefore, it might as well accept payment through the Fund and use the Fund in turn to pay for current imports. However, if a member does have a favorable balance on the whole, it may be able to accumulate reserves rather than Fund drawing rights. If it is not indebted to the Fund on account of past operations, it could accumulate reserves to the full amount of its favorable balance if it received payment in reserves rather than in its own currency purchased from the Fund. If it is indebted to the Fund, it would be required to use half the increase in reserves to repay the part borrowed from the Fund.

If there were a serious effort on the part of member countries to prevent other countries from making payments to them by obtaining their currencies from the Fund, the whole Fund mechanism might be weakened. Currencies of certain countries would remain in the Fund, even though those countries had favorable balances of payments, while other currencies, e.g. dollars, would be drawn from the Fund to make payments to such countries. Countries with favorable balances on the whole which were not indebted to the Fund could accumulate dollars. The danger of dollars becoming scarce in the Fund would be increased, but it is doubtful if the amount of dollars which members would accumulate in such circumstances would be very great for some years to come.

There is no reason to expect individual deficit countries in normal circumstances to take steps to prevent such a development as long as the Fund does not operate on a bilateral basis. Even though paying countries may be anxious to meet deficits through the Fund, they will be quite willing to make payments in currencies other than that of the receiving country, provided these currencies are obtainable from the Fund for the purpose.

If members continue to export in large part for payment in their own currencies, or in the currency of the buying country, they may find that they are paid in part for any excess of current exports over current imports in their own currencies drawn from the Fund. To the extent, of course, that sales are made for payment in a third currency, e.g. dollars, they may get paid in dollars. If members want to accumulate the maximum of reserves as a result of their favorable balances of payments, they may take certain positive steps to bring about this result. Members could even require their citizens to sell for payment in dollars rather than in their own currencies so that they would accumulate a maximum amount of dollars. As long as paying countries can obtain dollars from the Fund to make payments to countries other than the United States, they will be quite willing to pay in dollars unless they are ineligible to use the Fund or the dollar has been declared "scarce."

If dollars are becoming scarce in the Fund and dollars drawn from the Fund are being used to make payments to, and increase the reserves of, countries other than the United States, the Fund may decide to adopt a bilateral policy, i.e. to make dollars, e.g., available to a member only to the extent of that member's deficit with the United States. Members would then have reason to forbid free exchange transactions and invoke the repatriation principle in order that they could be sure of being able to meet a deficit with any given country by drawing on the Fund.

The adoption of a bilateral policy on the part of the Fund would not necessarily prevent dollars from being drawn from the Fund indirectly to meet payments to countries other than the United States. Members might be willing to use their own reserves of gold or dollars, e.g., to meet payments to other countries because they were able to draw dollars to meet their deficit with the United States. However, the Fund could even go so far as to refuse dollars to a member which was using its own gold or dollar reserves to meet payments to countries other than the United States, which payments could be made by purchases of those countries' currencies from the Fund. This would be rather a drastic policy for the Fund to adopt and difficult to enforce. Even the simple bilateral policy would be difficult to enforce without roughly accurate balance of payments forecasting year by year.

A country which was very anxious to obtain payment for its excess exports in gold or dollars might take other measures to achieve its ends even if the Fund did adopt a bilateral policy. It might use political bargaining weapons. Or it might offer a high price for foreign gold to induce sales of gold to it. However, the price paid by a member for gold can not exceed par by more than a margin to be prescribed by the Fund. The Fund can prevent sales of gold to members for their currencies by itself offering the maximum price, since members are obligated to sell gold to the Fund for foreign currencies if they can do so with equal advantage. In this way the Fund would be able to use the currency of any member which other members wished to purchase with gold and such members would receive payment through the Fund. Since most members must use their reserves at the same rate that they draw on the Fund, the Fund could obtain large amounts of gold in this way.

On the whole, then, the danger that the dollar will be scarce, while certain currencies remain unused in the Fund and dollars are drawn to meet payments to, and increase the reserves of, countries other than the United States, is not great. If necessary, the Fund could adopt a bilateral policy and members would then tend to invoke the repatriation principle, thus forcing favorable balance countries to take payment in their own currencies drawn from the Fund.

Conclusions

The analysis in this paper of certain features of the Fund Agreement and of the exchange operations of the Fund suggests that the answers to the questions raised in the Introduction are not clear. The following tentative conclusions may be offered, however.

A member of the Fund will be assured that other members will not normally be allowed to use exchange devices to limit purchases from it. Even in normal circumstances, however, a member is not obligated to allow the free exchange of its currency for others, even though its currency has been recently acquired by nonresidents as a result of current transactions or its own residents wish to obtain other currencies to make payments for current transactions. What a member is obligated to permit, in normal circumstances, is (1) exchange by a resident of another member country of holdings of its currency, recently acquired as a result of current transactions, into the currency of that member and (2) payments for current transactions by its own residents to a resident of another member in that member's currency. Members in general, then, have the right to be paid for current exports in their own currencies.

If a member is paid for an excess of exports to another country in its own currency, it will normally be able to use the proceeds of these exports to finance current purchases from other member countries. To the extent that a member is paid in its own currency purchased outside the Fund, it is assured of financing purchases in other countries. However, if a member receives payment in its own currency purchased from the Fund, it will not be enabled thereby to finance current purchases in other member countries if it is unable to draw on the Fund for reasons other than that the quantitative limits on the Fund's holdings of its currency had been reached. The two possible reasons are either (1) that it has been declared ineligible to use the Fund or (2) that current conditions are such that use of the Fund would be contrary to its purposes. Although the first is a quite abnormal case, the second is not so clearly abnormal. In neither case does the member receive a guarantee that it will be able to finance purchases in a country the currency of which has been declared scarce. This is clearly an abnormal case.

Members are not likely to insist on their right to prevent free exchange transactions for current payments and allow payments to other members only in their own currencies in normal circumstances, however. In the abnormal cases of a scarce currency or discriminatory restrictions on capital and current transactions, members might do so. These conclusions are based on the assumption that the Fund is willing to sell a foreign currency to a member without regard to whether the deficit being met by that member is with the country the currency of which is requested.

If the Fund decided to make the currencies of other individual countries available to a member only to the extent necessary to meet its deficits with the individual countries, members might invoke the repatriation principle and allow payments to other members only in their own currencies. In other words, only if the Fund decided to operate on a bilateral basis would members be likely to do so in normal circumstances. Only in this way would members be assured that they could meet pressure in their exchange markets by drawing on the Fund rather than by using their reserves.

Members have every reason to consider drawing rights on the Fund slightly less valuable than their own reserves. There is little danger that they will be allowed to use the Fund unwisely, however, should they be tempted to do so. The repurchase provisions and the Fund's ability to insist that the resources of the Fund are to be used on a temporary basis constitute important and adequate safeguards. It is possible that members will try to accumulate reserves rather than Fund drawing rights. If they are not indebted to the Fund, they may be able to do so to the extent of their overall favorable balance. They might accumulate dollars while dollars were being drawn from the Fund to meet payments to them. The size of the gold or dollar reserves which members are likely to accumulate in the near future is strictly limited, however.

The Fund might adopt the "bilateral" method of operation if a certain currency, e.g. dollars, were being drawn from the Fund to finance payments to countries other than the United States and these countries were accumulating dollars while dollars were becoming scarce in the Fund. If the Fund is properly managed, however, there is little danger that dollars will become scarce in the Fund in the near future.