

DEVALUATION-BIAS AND THE BRETTON WOODS SYSTEM COMMENT

In an article in the June 1972 issue of this journal, Samuel I. Katz ascribes "the presumption that there is a devaluation-bias in present international monetary arrangements" to the hypothesis, "widely affirmed in the standard literature in international economics", that the burden of balance-of-payments adjustment rests with deficit countries (which cannot lose reserves forever), rather than with surplus countries (which can continue to accumulate reserves).

In this connection, it is worth recalling that during the first ten to fifteen years of the Bretton Woods system much of the literature on the subject also was responsible for another hypothesis, with a similar built-in devaluation-bias. That hypothesis was that external disequilibrium in general and "fundamental disequilibrium" in particular meant virtually without fail a balance-of-payments deficit.

Such a one-sided interpretation was of course not in the spirit of the IMF's Articles of Agreement, which are quite noncommittal in that respect. They simply state that "a member shall not propose a change in the par value of its currency except to correct a fundamental disequilibrium"¹ and that "the Fund shall concur in a proposed change... if it is satisfied that the change is necessary to correct a fundamental disequilibrium"² without any further hint as to the direction in which such an imbalance is presumed to be running.

However, even the earliest interpretations of the Fund rules immediately and unequivocally equated such a disequilibrium to a deficit. Thus, in late 1944 Haberler wrote:

But does it follow — positively — that "fundamental disequilibrium" should be defined as a serious and protracted loss of gold due to a persistent deficit in the current balance of payments? This is certainly the standard case of disequilibrium on which all experts would agree.³

and:

Our conclusion then is that "fundamental disequilibrium" should be interpreted in terms of an objective, unambiguous, and observable criterion. Such a criterion can be only an actual deficit in the balance of payments.⁴

¹ Article IV, Sec. 5 (a).

² *Ibid.*, Sec. 5 (f).

³ G. HABERLER, "Currency Depreciation and the International Monetary Fund", *Review of Economics and Statistics* (November 1944), p. 178.

⁴ *Ibid.*, p. 181.

Haberler takes this stand, although he subsequently admits elsewhere that "the term 'fundamental disequilibrium' was introduced by the Bretton Woods Agreements, without giving any definition, leaving it to the practice of the Fund to evolve suitable criteria".⁵ In view of the difficulty of arriving at any one firm criterion, this vagueness may of course have been intentional.⁶ Although to Bloomfield it also "seems legitimate to treat a 'fundamental disequilibrium' primarily from the viewpoint of deficit countries alone", he at least visualizes the opposite situation where "a balance-of-payments surplus threatens to provoke in a country a general price inflation which cannot otherwise be easily controlled".⁷

Other writers who argued that an exchange-rate adjustment might be called for even in the absence of an overt balance-of-payments deficit, nevertheless saw a disequilibrium mainly as a short-fall of foreign demand for exports, manifested in the form of deflationary pressures on prices and wages in the export industries. Thus, in commenting on Haberler's views, Hansen wrote:

If a country is under continuous and strong price deflationary influences from the outside world, it can, I think, be concluded that the country's exchange rate is out of line and should be adjusted. This is a case of a fundamental disequilibrium.⁸

In a similar interpretation of the Fund's intentions, Goldenweiser and Borneuf wrote:

In order to protect member countries from deflationary pressures resulting from inability to adjust exchange rate to world conditions, it is provided that the Fund must concur in a proposed change if it is satisfied that the change is necessary to correct a fundamental disequilibrium.⁹

An equal bias towards seeing an external imbalance only as a deficit continues to be shown by later writers who were no longer concerned with a narrow interpretation of the Fund's language, but rather with the broader relationship between domestic monetary policy and balance-of-payments adjustment. These authors likewise tended to discuss such a relationship exclusively

⁵ G. HABERLER, "Comments on 'National Central Banking and the International Economy'", *International Monetary Policies*, Postwar Economic Studies, No. 7 (Washington: Board of Governors of the Federal Reserve System, 1947), p. 89.

⁶ It might be noted, however, that the Keynes plan for an International Clearing Union suggested suitable measures to be taken by persistent deficit as well as by persistent surplus countries.

⁷ A. I. BLOOMFIELD, "Foreign Exchange Rate Theory and Policy", in S. E. HARRIS, ed., *The New Economics* (New York: Alfred A. Knopf, 1949), p. 304.

⁸ A. HANSEN, "A Brief Note on 'Fundamental Disequilibrium'", *Review of Economics and Statistics* (November 1944), p. 183.

⁹ E. A. GOLDENWEISER and A. BORNEUF, "Bretton Woods Agreements", *Federal Reserve Bulletin* (September 1944), p. 852.

in terms of an external deficit that was to be corrected by means of a restrictive monetary policy.¹⁰

This unconscious bias, on the part of both sets of writers, may well have reflected the early postwar environment which, with its memories of the exchange depreciations of the 1930's, its dollar shortage, and its general distortions of the international trade and payments mechanism, made it seem unlikely that any country would need to take early action against a protracted balance-of-payments surplus. The specific discussions surrounding the meaning of the Fund's articles, moreover, mirrored of course the Fund's *raison d'être* as a supplier of short-term credit to member countries in temporary balance-of-payments difficulties.

But the exclusive emphasis on an *adverse* foreign balance as the proper target for monetary policy measures stemmed most likely from the asymmetrical effect often ascribed to monetary policy, i.e., its greater effectiveness in damping excess demand than in stimulating demand when economic activity is slack. By analogy, the same effects were transferred to the workings of monetary policy with respect to the external sector, i.e., to balance-of-payments disequilibrium. This seems all the more logical if one recalls that, prior to the reversal in German policy in 1960, there simply had been no instance of a country consciously adopting an expansionary monetary policy in order to reduce an external surplus.¹¹

It may well be, therefore, that the alleged devaluation-bias of the Bretton Woods system, at least in its early years, reflected prevailing conditions and circumstances rather than any inherent defect in international monetary arrangements.

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¹⁰ Cf. for example R. J. FAMILTON, "Balance of Payments Equilibrium and Monetary Policy", *Economic Record* (November 1954), p. 221; R. NURKSE, "The Relation Between Home Investment and External Balance in the Light of British Experience", *Review of Economics and Statistics* (May 1956), p. 146; and P. B. KENEN, *British Monetary Policy and the Balance of Payments, 1951-57* (Cambridge: Harvard University Press, 1960), p. 35.

¹¹ For a discussion of that episode and its background, see J. HEIN, "Monetary Policy and External Convertibility: The German Experience, 1959-61", *Economia Internazionale* (August 1964).