NBER WORKING PAPER SERIES

FROM THE EXCHANGE STABILIZATION FUND TO THE INTERNATIONAL MONETARY FUND

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Working Paper 8100
http://www.nber.org/papers/w8100

NATIONAL BUREAU OF ECONOMIC RESEARCH
1050 Massachusetts Avenue
Cambridge, MA 02138
January 2001

For helpful suggestions we thank Jacques Polak, Jim Boughton, and participants at the PEIF conference at Harvard University, 27 October 2000. The views expressed herein are those of the authors and not necessarily those of the National Bureau of Economic Research.

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NBER Working Paper No. 8100
January 2001
JEL No. B22, F33

ABSTRACT

We highlight the elements of the operation of the U.S. Exchange Stabilization Fund that Harry Dexter White, who directed the Treasury's division of monetary research, transferred to his plan for the operation of the International Monetary Fund. The elements included the principle that all currencies were equivalent and the goal of the international fund, like that of the U.S. fund, was to stabilize exchange rates. The ESF also influenced White's vision for the International Bank for Reconstruction and Development. The IBRD, however, represented a reaction by White against key elements of ESF stabilization loans, which were very short term, paid above market interest rates, and required collateral. Had White carried forward to the IMF the ESF elements pertaining to interest rates and collateral, its operations would have evolved in a markedly different direction from the one that it has taken.

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Michael D. Bordo and Anna J. Schwartz

There are significant affinities between the U.S. Exchange Stabilization Fund (ESF) and the International Monetary Fund (IMF). This paper investigates how they came to pass. Since the ESF predated the IMF by thirteen years, the existence of common features implies that transmission was from the older to the younger institution. For that to have happened, the key player must have been Harry Dexter White.

We first briefly describe the mission of each institution (section 1). Although our main focus is on the connections between the ESF and the IMF, we also pay some attention to the influence of the ESF on White's plans for the IBRD – the sister international financial institution founded at Bretton Woods in July 1944 --so we include a discussion in this section of the IBRD's mission.[1] We then explore White's role in creating the links between the ESF and the international institutions (section 2). We demonstrate that White's ideas about the need for a bank to provide long-run development loans also reflected his participation as the Treasury representative on a committee to design an Inter-American Bank. We summarize the similarities as well as the differences between ESF and IMF procedures (section 3). We consider how the IMF might have performed had it not been designed to operate along the ESF lines that White proposed (section 4). We address three questions: Suppose the IMF had adopted ESF interest rate and collateral practices instead of imposing conditionality in extending financial assistance, how different would both the IMF and emerging market countries be today? Would recent proposals to transform the IMF into an international lender of last resort achieve

[1] We refer to the IBRD (the International Bank for Reconstruction and Development), when we discuss White's plan for the institution. We refer to the World Bank, when we discuss the operating World Bank.

this change from conditionality to ESF interest rate and collateral practices? Suppose the IMF had not adopted the ESF fiction that all currencies are equal, how different would IMF operations and emerging market countries' behavior have been? Some concluding remarks follow (section 5).

1. Missions of the Three Institutions

1.1 Mission of the ESF

The Exchange Stabilization Fund was established in accordance with a provision in the Gold Reserve Act of 31 January 1934. The act assigned to the ESF the paper profit from gold devaluation to be used in foreign exchange market intervention, authorizing it to deal in gold and foreign exchange in order to stabilize the exchange value of the dollar. According to the report of the House Banking Committee on the bill that became the act, "This stabilization fund is a new and most interesting development. It is new in this country, although it has operated very successfully for many months in the monetary systems of our principal competitor in international trade" (73d Cong, 2d sess, Report 201, p. 203). (The unnamed "principal competitor" was Great Britain, and the reference was to its Exchange Equalisation Account – EEA -- that was formally initiated on 1 July 1932.)

The report continued: "It is interesting because it is the most ingenious instrument ever developed in the monetary systems (sic). It is equally effective in attack and defense. The reason for its establishment in this case is to defend the American dollar and our gold stocks against the invasion of similar funds operated by competitor nations." (In 1934, only Great Britain and the U.S. had stabilization funds. Other countries created stabilization funds when they joined the Tripartite Agreement in 1936.) Thus it was suspicion of the purpose of the EEA that motivated the establishment of the ESF. U.S. officials and members of Congress regarded

the EEA as a mechanism to depreciate the pound to gain competitive advantage in international trade at the expense of U.S. exports.

The ESF was established at a time when the U.S. dollar was pegged to the price of gold at $35 an ounce, currencies of some continental European countries were on the gold standard with a variable gold price, the value of the German mark was determined by exchange controls and import licensing, and the value of the British pound floated.

The Gold Reserve Act of 1934 also authorized the Fund to use such assets as were not needed for exchange market stabilization to deal in government securities. It had no statutory authority, however, to engage in other activities that early on it began to undertake. The principal such extraneous activity it devoted itself to was lending dollars to politically favored foreign governments.

1.2 Mission of the IMF

The IMF began operations on 1 March 1947, when forty countries had been admitted to membership after signing the Articles of Agreement (dated 22 July 1944, as the Final Act of the United Nations Monetary and Financial Conference held at Bretton Woods). The Agreement embodied the idea that a properly working international monetary system was based on convertible currencies. The aim was to assure exchange rate stability in the service of expanding international trade. The Agreement also authorized the IMF to provide financial assistance to individual countries to eliminate balance of payments maladjustments.

The plan for the functioning of the IMF was outlined in the Articles, of which we note the subjects of the first eight of twenty. Following a statement of the purposes of the Fund (Article I), which countries were to be members of the new organization are classified (Article II), to qualify for membership, each country would provide gold, its currency, and its government securities payable on demand in that currency to the Fund (Article III), the determination of the

par value of each country's currency (Article IV), conditions governing members' use of the Fund's resources (Article V), controls on capital transfers (Article VI), measures to deal with a general scarcity of a particular currency (Article VII), obligations of members to avoid restrictions on current account payments or multiple currency practices, and to furnish information (Article VIII).

1.3 Mission of the IBRD

Formal operations of the Bank began on 25 June 1946, when 2% of the subscriptions of member countries to its initial capital of $10 billion were due. The initial paid-in subscription was to be one-half in gold and one-half in local currency. The Bank, however, was authorized to raise additional funds in the private capital market. Its objective was to provide both short- and long-term loans or to participate in loans for relief, reconstruction, and development to any member, or any political subdivision thereof, and to any business or agricultural enterprise in the territory of a member. The Bank had to be assured that the borrower could not otherwise obtain a loan at a reasonable rate of interest. When the member was not itself the borrower, it or its central bank was to guarantee repayment to the Bank of principal and interest. The Bank was also to guarantee loans of private investors with suitable compensation for its risk. The Bank would buy, sell, and hold gold and the obligations and securities of member governments.

The plan for the functioning of the IBRD was outlined in the Articles of Agreement, of which we note the subjects of the first five of eleven (Department of State 1948, pp. 984 ff.). Following a statement of the purposes of the Bank (Article 1), the membership and capital of the Bank are prescribed (Article 2), the general provisions relating to loans and guarantees are noted (Article 3), the methods of making or facilitating loans are described (Article 4), the organization and management of the Bank are described (Article 5).

1.4 Background to the Missions

As is well known, in 1938-40 White had worked on a proposal for loans to Latin America and participated in plans for an Inter-American Bank, which had not materialized (Oliver 1975, pp. 92-99). The plan for an Inter-American Bank, however, inspired the first draft of the subsequent plans for the IMF and the World Bank that White prepared in 1941. Several undated versions of the complete first draft are available among the White Papers at Princeton. A mimeographed "Suggested Plan for a United and Associated Nations Stabilization Fund and a Bank for Reconstruction and Development of the United and Associated Nations," dated April 1942, is reproduced in Oliver (1975, Appendix A, pp. 279-322). The two institutions that White envisioned, of course, were what soon became known as the IMF and the World Bank. We cite the Oliver version as draft 1, and another undated (but we assume later) mimeographed text as draft 2. We investigate the influence of White's experience at the ESF not only on his plans for the IMF but also on his plans for the World Bank. To do so, we report on the circumstances that led to his connection with the ESF and his pivotal role in the design of the two international financial institutions.

2. White's Role

Harry Dexter White had a brief academic career at Lawrence College in Appleton, Wisconsin, after obtaining his doctoral degree at Harvard in 1930. His prize-winning dissertation, *The French International Accounts, 1880-1913,* published in 1933, apparently brought him to the attention of Jacob Viner of the University of Chicago, who was then conducting a series of studies for the U.S. Treasury (Blum 1959, v.1, pp. 120, 298). In 1934 Viner invited White to come to Washington to work with him at the Treasury as a summer research appointee. Neither Viner's nor White's name appears in the 1934 Treasury annual report. In the 1935 report, however, White is listed as one of five assistants to the director of the

division of research and statistics (established 17 September 1934), and one of six in 1936-37 (Oliver 1975, p. 81).[2] In 1938, when the division of monetary research was established, White became its director, with one assistant director, a position he held thereafter, with two or more assistant directors. On 15 December 1941, he was appointed assistant to the Treasury secretary to act as liaison between the Treasury and the State Department on all matters having a bearing on foreign relations, and "responsibility for the management and operation of the stabilization fund without change in existing procedures" (1942 Treasury annual report, p. 335, Order no. 43). In January 1945, White was appointed Assistant Secretary of the Treasury. He resigned from the Treasury on 1 May 1946 to become the first U.S. Executive Director of the IMF. During the institution's first year, whenever the Managing Director was not at headquarters, White served as Acting Managing Director. Embroiled in a political assault on his loyalty, White resigned his post in March 1947, and died the following year, a few days after testifying before the House Committee on Un-American Activities.[3]

The final version of the design for the IMF and the World Bank was an amalgam of proposals by White and Keynes, with a preponderance of White's proposals. He prepared and represented U.S. views on the shape of the postwar international financial order. The competing plan by Keynes represented British views.[4]

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[2] James R. Boughton has called to our attention a statement by David Rees in his 1973 biography of White that, starting in 1937, White's salary was paid from the ESF budget, because his post was not in the civil service. He was therefore not on the regular Treasury payroll.

[3] See the discussion of the allegations that White was a Soviet spy in Boughton (2000) and Sandilands (2000).

[4] White proposed two international monetary organizations – one a stabilization fund to provide short-term loans to deal with temporary balance of payments shortfalls, the other to provide reconstruction and development loans. Members would contribute to the fund a quota consisting of gold and its own currency. Each would declare a par value for its currency in terms of "unitas" which it would thereafter maintain, but alterable upon consultation with the Fund if the proposed change was greater than 10%. Deficit countries would exchange their currencies for currencies of countries to which they were in debt. Keynes proposed , by contrast, an International Clearing Union that would provide overdraft facilities to its members. Credits and debits on the books of the Union would be recorded in "bancor", an international unit of account. The compromise plan established two international organizations, and required contributions from members based on their relative economic resources. The British gave up the ICU and bancor and the overdraft system, but gained an increase in the aggregate quotas for the Fund

White's unpublished papers of 1936-46 (in the Seeley G. Mudd Manuscript Library, Princeton University) include memoranda on the advantages stabilization funds provide, and on the desirability of providing stabilization loans to Mexico, China, and Brazil; drafts of letters for Secretary Morgenthau to send to Roosevelt on international policy; a report on Cuba's monetary and credit problems. As is clear from our earlier comments, White also was engaged, at Morgenthau's direction, in drafting the proposal for establishing the IMF.

As an employee of the Treasury Department, White was well-informed about three of its initiatives in the operation of the ESF. One was the formulation of the elements of stabilization agreements with selected countries. The second was the conduct of the Tripartite Agreement. The third was ESF dealings in markets for foreign exchange, gold, silver, and government securities. We discuss the part each played in the formation of White's conception of the IMF. We then explore three sources of White's ideas about the principles to guide the organization of a bank for development loans: the ESF, a memorandum on a proposal for Latin American loans, and the stillborn Inter-American Bank.

2.1 ESF Stabilization Loans

The first stabilization loan that the ESF extended was to Mexico in January 1936. We do not know who in the Division of Research and Statistics at the Treasury devised the terms of the loan. White's unpublished papers give no indication that he was a principal in the design of the loan, but he unquestionably was aware of its unique features. In any event, it became the model for subsequent stabilization loans to other countries in addition to Mexico. When he became the director of the division of monetary research in 1938, White administered stabilization loans.

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that White had proposed. Unitas, an international unit of account, was dropped from White's plan. See Gardner (1969), Van Dormael (1978), and Bordo (1993).

The terms of the Mexican loan were enclosed in a letter to the Federal Reserve Bank of New York as the Treasury's fiscal agent, which was instructed to send them to the Banco de Mexico. The letter follows:

"The Secretary of the Treasury of the United States has, as a result of his recent conversations in Washington with the Secretary of the Mexican Treasury, authorized us, as fiscal agent of the United States, to enter into the following arrangement with you, on behalf of the Republic of Mexico, for the purpose of supplying the Republic of Mexico with dollar exchange, from time to time, as may be required:

1. We, as fiscal agent of the United States, will purchase from you, from time to time, as requested by you, Mexican pesos, the pesos so purchased to be credited to us (as fiscal agent of the United States) on your books in a special account to be opened in the name of the "Federal Reserve Bank of New York as Fiscal Agent of the United States." Interest at the rate of 3% per annum in to be credited on such account. Upon receipt by us of advice by telegram that this account has been credited with a stated amount in Mexican pesos, we shall in turn credit you on our books in a special account to be opened in the name of "Banco de Mexico as Fiscal Agent of the Republic of Mexico" in an amount in U.S. dollars equal, at the then prevailing rate of exchange in New York for telegraphic transfers on Mexico, to the amount in pesos so credited to us on your books.
2. The total amount of pesos purchased by us from you and standing to our credit on your books as aforesaid, exclusive of interest, shall not at any time exceed in the aggregate the equivalent of U.S. $5,000,000, computed at the actual buying rate for such pesos.

3. You agree that any or all pesos purchased by us from you, together with interest thereon as aforesaid, and standing at any time to our credit on your books as aforesaid, shall be repurchased (in U.S. dollars) by you from us at any time, and from time to time, upon our request, at the same rate or rates of exchange at which pesos were purchased from you by us.
4. As security for the performance by you of your agreement to repurchase such pesos as aforesaid, you authorize and request Federal Reserve Bank of New York and Federal Reserve Bank of San Francisco to set aside from time to time and to pledge to Federal Reserve Bank of New York as fiscal agent of the United States, so much of the silver now held for your account under earmark by Federal Reserve Bank of New York and Federal Reserve Bank of San Francisco (amounting to approximately 11,000,000 ounces) as the dollar equivalent of pesos purchased and then standing to our credit on your books as aforesaid bears to U.S. $5,000,000; and in the event of your failure to repurchase such pesos as hereinabove provided, you do further authorize us as pledge aforesaid, to sell so much of such silver so held under pledge, at any time, at the so-called official price for silver as then quoted by Messrs. Handy & Harman, New York, New York, and to apply the proceeds thereof in such manner, as may be necessary to save us, as fiscal agent of the United States, and the United States, harmless from any loss by reason of any failure to repurchase said pesos as herein provided; and you do hereby authorize and request Federal Reserve Bank of San Francisco to honor any request made by us to hold or deliver for our account as fiscal agent of the United States, and as pledge aforesaid, any or all of the silver now held for your account under earmark by said Federal Reserve Bank of San Francisco.

5. It is understood and agreed that our obligation, as fiscal agent of the United States, to purchase any amount of pesos pursuant hereto shall be conditional and dependent upon your maintaining with us and/or the Federal Reserve Bank of San Francisco, an amount of silver sufficient to secure, as hereinabove in paragraph 4 provided, your obligation to repurchase such pesos.
6. It is understood you will take such further action as may be reasonably requested by us to effectuate the purposes and intent of this arrangement.
7. This arrangement shall continue in effect until February 1, 1936, and from month to month thereafter except that we, as fiscal agent of the United States, may on or before the fifteenth day of any month advise you that our offer to purchase pesos under this agreement, in so far as it has not been accepted, is to be discontinued at the end of that month." [5]

We comment on the unique features of this agreement. For the first time, so far as we are aware, instead of a loan of dollars by one country to another, the transaction is described as an exchange of currencies of the two contracting parties. The U.S. advanced $5 million to Mexico for pesos, which the Banco de Mexico agreed to repurchase on demand by the U.S. Treasury at any time at the exchange rate at which they had been acquired. Mexico, moreover, agreed to pay a 3% interest rate (the discount rate was then 1 ½ % at the Federal Reserve Bank of New York, and the prevailing rate on 4- to 6- months commercial paper was 0.75%) on the

[5] The 1936 Treasury annual report contains no reference to the stabilization agreement with Mexico. The text of the letter to the Federal Reserve Bank of New York that was forwarded to the Banco de Mexico comes from an unpublished study of the ESF, 1934-39, by William Adams Brown, Jr., dated 1942. Our efforts to learn how Brown obtained such early access to official documents of the Federal Reserve Bank of New York were fruitless.

peso account credited to the Bank.[6] In addition, Mexico was required to provide silver collateral equal to the dollar amount of the exchange of currencies. [7]

Collateral requirements were not uncommon during the interwar years. League of Nation loans were collateralized by export income. The BIS also required collateral. Before World War II all ESF loans featured collateral requirements. During the war, however, collateral was waived for countries deemed important to national security, e.g., China, Brazil.

In section 3, we check the Articles of Agreement of the IMF to determine the extent of the influence of the ESF model stabilization agreement on the design of IMF financial assistance to member countries.

2.2 ESF Participation in the Tripartite Agreement

Before arriving at an agreement with the French and with the British in September 1936, the U.S. Treasury and members of Congress had regarded the British as an adversary in the foreign exchange market. Under the terms of the Agreement, which accepted a need for devaluation of the franc, the three countries plus Belgium, Switzerland, and the Netherlands, which joined later and also subscribed to it, adopted the principles of mutual consultation with respect to the level of exchange rates and reciprocity in gold dealings.

Each central bank committed to convert into gold the balance in its own currency that the other central bank had accumulated each day as a result of its exchange control operations and to make available from earmark gold to meet obligations undertaken by the foreign central bank as a result of such operations. In addition, the central banks agreed to advise each other daily of transactions as a result of which gold was earmarked or released.

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[6] The Brazilian stabilization agreement of July 1937 set the interest rate at ½ of 1% above the average rediscount rate of the Federal Reserve Bank of New York (in June 1937 1 ½%). For a list of ESF loans, see Schwartz (1997) and Henning (1999).

[7] Mexico borrowed dollars on 10 and 22 January 1936, and repurchased pesos on 26 May and 9 June 1936, for an aggregate in dollar amounts of $4.7 million.

One feature of the Tripartite Agreement thus was that it provided not for loans between the signatories but for an exchange of gold for currencies.[8] A second feature was that, at least for each twenty-four hour period, debtors would not need to adjust exchange rates or apply exchange controls. The Agreement facilitated settlement of multilateral balances. A third feature was that, by mutual agreement between two countries, on twenty-four hours' notice, a change in the exchange rate could be effected.

Cooperation and reciprocity among countries that the Tripartite Agreement fostered became principles that served as the bedrock of the IMF Articles of Agreement.

2.3 ESF Dealings in the Markets for Foreign Exchange, Gold, Silver, and Government Securities

Intervention by the ESF in the exchange market was conducted on its behalf by the Federal Reserve Bank of New York, which was authorized to purchase or sell the kinds of exchange that the Treasury designated. The Treasury agreed to provide the dollars and foreign exchange required to fulfill the contracts the Bank entered into. The ESF's intervention in support of the dollar involved sales of sterling and francs in New York or dollars bought in London and Paris for its account. Intervention in support of sterling or the franc involved purchases of sterling and francs bought in New York or dollars sold in London and Paris for its account, or by the purchase of sterling to pay for gold and silver bought in London. The way foreign central banks obtained a supply of dollars with which to intervene was that the Treasury earmarked gold abroad against an advance of dollars in New York or it purchased gold abroad against immediate payment in dollars.

The system of U.S. gold regulations established under the Gold Reserve Act drew a distinction between foreign central banks that bought and sold gold at a fixed price and those that

[8] Currency swaps under the Tripartite Agreement have been cited as the precedent for the doctrine that all currencies are equal (Horsefield 1969, pp. 6-7; Polak 1999, p. 5). The Mexican Stabilization Agreement of January 1936,

did not. No special license was required by central banks of gold standard countries to acquire gold from the U.S. Treasury as long as their exchanges were below gold export points. However, the Treasury secretary was empowered to grant licenses to other central banks if their purposes were consistent with the Gold Reserve Act. The Federal Reserve Bank of New York in turn was licensed to receive gold from abroad or acquired in the U.S. by foreign central banks or governments and to export it.

The Tripartite Agreement led to a withdrawal of the forgoing gold regulations. A central bank of a country that adhered to the Agreement could not on its own account acquire gold from the U.S. Treasury and have it earmarked free for export at the Federal Reserve Bank of New York without a special license for each transaction, and even when acting as fiscal agent for its exchange stabilization fund or its government, it could not acquire gold from the U.S. Treasury and have it earmarked, unless twenty-four hours' notice of the transaction had been given and special accounts had been set up for implementing the transaction.

The ESF was authorized to buy spot or forward silver in any market through the Federal Reserve Bank or its agents and to hold silver so bought in any one of fourteen foreign depositories located in London and New York. The ESF was also authorized to sell silver through the Federal Reserve Bank. The Fund sold gold for sterling, then bought silver abroad with sterling for sale to the Treasurer of the U.S. under the Silver Purchase Act of June 1934. The ESF also bought silver elsewhere mainly from the Central Bank of China and the Banco de Mexico for dollars.

The ESF's authority to invest in direct obligations of the U.S. in effect sanctioned it to engage in open market operations, but Morgenthau declared the primary purpose of the ESF in holding government securities was to obtain earning assets.

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however, antedated the Tripartite Agreement. Indeed, treating the peso as a peer to the dollar was a far greater leap

White's job afforded him the opportunity to familiarize himself with these activities of the ESF. In the section that follows we note the extent to which his experience influenced his vision of the ways in which the IMF might operate. Since the ESF was a domestic institution with international scope while the IMF was to be an intergovernmental institution that would have an international membership, the new institution could not be merely a carbon copy of the existing one. There was room for differences as well as similarities between the two.

2.4 Influences on White's Design of the IBRD

White's experience as a Treasury official made a contribution to several features of his plans for the IBRD. We note three events that were part of his experience and two features of the plan. The events are: (1) the Mexican stabilization loan of January 1936; (2) the undated (1939?) 6-page memorandum "Loans to Latin America for the Industrial Development of Latin America"; (3) the proposals for an Inter-American Bank that originated in a meeting in Panama in 1939. The features of the IBRD are: (1) low-interest loans; (2) government guarantees of private investor loans. We comment on each event and feature.

1. The Mexican stabilization ESF loan that became the prototype for its pre-war lending was notable for its limited amount, limited duration, and above market interest rate. These aspects of the loan must have impressed White as unresponsive to Mexico's real needs, as we discuss below.
2. White's memorandum included a proposal that the U.S. establish a bank with a capital of $300 million (funded by the ESF's unused gold), authorized to issue up to $1.7 billion in U.S. government-guaranteed bonds, to make long-run loans for industrial enterprises in Latin America under the control of the borrowing country or its nationals. Loans would be offered at no more than 1 percent in excess of the cost

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of faith than treating the pound and franc as equal.

of borrowing by the bank. Three-quarters of the dollar loans was to be expended on imports from the U.S. [9]

3. White was appointed by Morgenthau to serve on an interdepartmental committee on plans for an Inter-American Bank, the aim of which was to frustrate Nazi penetration in Latin America. The charter that was drafted in 1940 would have authorized the bank to make loans, or guarantee loans made by others, in any currency or gold to member governments, their nationals, fiscal agencies, and central banks. Governments were to guarantee that loans of more than two-years maturity would be repaid. The Bank could hold obligations and securities of member governments, their currencies or foreign exchange, for its own account or the account of member governments. It could hold deposits of member governments, rediscount bills arising from intra-hemisphere trade that commercial banks discounted, and issue its own obligations. Only Mexico ratified the Inter-American Bank Convention. A U.S. Senate subcommittee, which held hearings on the subject in 1941, took no action. White, who championed economic assistance to Latin America, China, and the Soviet Union, extracted some of the elements in the Inter-American Bank proposal in preparing his blueprint for a World Bank.

4. One feature of the World Bank that White espoused was that it should make loans at artificially low (i.e., below market) interest rates (Oliver 1975, pp. 120-122). He insisted that the Bank should limit its loans to cases where otherwise private capital markets would lend at high (relative to those that would obtain in advanced countries)

[9] In Jan.1948, after White's resignation from the IMF, he wrote a 66-page memorandum for the Mexican government for whom he was a consultant, proposing a 25-year stabilization credit of $1 billion from the U.S. Treasury, consisting of a commitment to sell on demand dollars to the Bank of Mexico for peso deposits in the Bank of Mexico, the Bank to limit resort to the ESF to a maximum of $100 million in any 12-month period. Confidence in Mexico's stability as a result of the program would stimulate private investment flows to raise the level of productivity there.

interest rates. In part, his attitude derived from his genuine concern to help the impoverished and war-torn countries of the rest of the world. White, however, in effect substituted the decision of the Executive Directors of the Bank for the market's decision on which projects were worth funding to the extent that the lending decisions did not involve projects where the social return exceeded the private return and the private sector would not have funded them. In fact, many of the Bank's loans in the 1950s and 1960s to finance steel mills and the like were abysmal failures (Krueger 1998). Because demand at artificially low interest rates exceeded supply, the IBRD had to ration its available funds among borrowers. It was decided in negotiations between the British and the Americans before Bretton Woods that the Bank would not differentiate among borrowers by varying the interest rate that it charged. If there was a difference in rates charged, it reflected the interest rate the Bank had to pay to obtain funds.

5. A second feature of the blueprint of the World Bank was the emphasis on the need for government guarantees of the repayment of private loans for reconstruction and long-run development. White was responding to the default on international loans in the 1930s and the concurrent shutoff of foreign lending. In order to generate a flow of private capital to foster capital formation and growth in the postwar period, White was convinced that government guarantees of the debts of private borrowers were essential.

In the next section, we compare the ESF and the IMF, noting the respects in which they were similar or differed. Low interest rates was not an ESF characteristic, but White introduced it into the IMF and the IBRD. Loan guarantees were not a characteristic of the ESF nor of the IMF, but White introduced them into the IBRD, possibly a legacy of the Tripartite Agreement.

In this case, Keynes at Bretton Woods supported White's emphasis on Bank guarantees of private overseas investment (Oliver 1984, pp. 34-35).

3 Differences and Similarities Between the ESF and the IMF

We begin with the similarities. For the description of the ESF we draw on official documents and the record of its practices. For the IMF we draw on White's preliminary drafts that envisage its operations. We note divergences between his blueprints and the final version adopted at the Bretton Woods Conference.

- The ESF was established to stabilize the exchange value of the dollar, the IMF "to provide an instrument with the means and the procedure to stabilize foreign exchange rates" (Draft 1, Oliver 1975, p. 281).
- The composition of both the ESF and the IMF with one exception was similar. Each consisted of gold, foreign currencies, and securities, in the case of the ESF, U.S. government securities; in the case of the IMF, securities of member governments. The ESF also held silver assets.
- For both the ESF and the IMF rates of exchange were based upon the value of a currency in terms of U.S. dollars which had prevailed since the Gold Reserve Act of 1934. For the IMF foreign exchange dealings were based on par values, which the ESF did not specify.
- Both the ESF and the IMF had authority to buy, sell, and hold gold, currencies and government securities, to earmark and transfer gold, and to buy and sell government securities. The IMF in addition was authorized in White's draft to issue its own obligations, and to offer them for discount or sale in member countries. This provision did not appear in the Articles of Agreement but the IMF was authorized in the Articles to borrow. The IMF has borrowed from a

broad range of member countries and central banks to supplement the amounts it can lend.

- The ESF provided dollars in exchange for the currencies of countries with which it established exchange stabilization agreements. The IMF provided foreign exchange to a member country in exchange for its own currency in order for it to meet an adverse balance of payments predominantly on current account.
- Both the ESF and the IMF designated the agencies with which they would deal: a country's Treasury, central bank, stabilization fund (in the case of the ESF, beginning with the Tripartite Agreement).

We have noted in listing similarities some divergences between the domestic and international institutions related to the common feature. Now we comment on differences unrelated to common features.

- The ESF was a U.S. nationalist response to the British EEA. It is interesting that White proposed that the IMF "pierce at the weakest points the type of extreme nationalism" (draft 1, p. 8 of the mimeographed version; Oliver 1975, p. 284, gives a revised version: "A breach must be made and widened in the outmoded and disastrous economic policy of each-country-for-itself-and-the-devil-take-the-weakest").
- The ESF extended very short-term currency swaps. White proposed a term of one year or less for member country currency borrowing from the IMF (draft,1,Oliver 1975, pp. 287-88).

- Investment by the ESF and the IMF was limited to government securities. White proposed to extend the right to include commercial securities (draft 1, Oliver 1975, p. 287).
- White would have denied currency to a borrowing country when the currency was to be used to make possible adjustment of a government foreign debt which had been defaulted (draft 1, Oliver 1975, p. 287). This limitation would have prevented the ESF Mexican rescue in 1995, when dollars were used to pay foreign holders of tesobonos.
- The ESF did not fix the exchange rates at which it transacted. In White's proposal, the IMF fixed the rates which it would exchange a member's currency for another (draft 1, Oliver 1975, p. 287).
- The ESF charged an interest rate above the discount rate at the Federal Reserve Bank of New York. White proposed that the IMF be a source to which member countries "could turn in time of need to borrow at very low rates of interest" (draft 2, p. II-34).

The transformation of the ESF into the IMF excluded many features that uniquely characterized the international institution, such as the quota system, subscriptions by the members, the organization and management, the emphasis on scarce currencies. Those aspects of the ESF that carried over to the IMF, however, shaped the institution in ways that lead us to speculate whether the performance of the IMF would have benefited had it operated under a different set of ESF guidelines. We turn to this matter in the following section.

4 What the IMF Would Have Been Like Had White's Proposals Differed[10]

White's proposals for the IMF were based on the ESF principle that all currencies were equivalent and that the goal of each fund was to stabilize exchange rates. There were other features of the ESF, however, that he might have deemed of sufficient importance for the IMF to replicate. The terms of the stabilization loans that the ESF extended during White's tenure were commercial: short-term, extended at a market rate of interest, and collateralized with silver or gold. Commercial terms did not fit with White's vision for the IMF. He was imbued with idealism in formulating his utopian plan for the future international financial institutions. They were to "pave the way and make easy a high degree of cooperation and collaboration among the United Nations in economic fields hitherto held too sacrosanct for international action or multilateral sovereignty"(draft 1, Oliver 1975, pp. 283-284). Thus it was that White opted not for commercial terms for IMF loans but "very low interest rates" in a setting of pervading neighborliness and good will

4.1 IMF as a Lender on Commercial Terms and No Conditionality

Once the IMF began operations its practices in providing credit to member countries evolved in ways that White had not envisioned. Countries draw on the fund in tranches that are based on the size of their quotas, the first tranche equal to 25% of a member's quota that was to be automatically available with no conditions attached. By 1952, both within the IMF and outside it, "the death of automaticity" was recognized (James 1996, p. 78). Higher tranches were to be negotiated and the credits would come with conditions the member was expected to fulfill. The method of operations henceforth also provided for approving "stand-by facilities" – approving drawings in advance, should they be needed – which made balance-of-payments assistance available on condition that the member agreed to implement detailed changes in

[10] Following ESF principles would also have meant a different evolution for the IBRD.

macroeconomic conditions.[11] So the path that the IMF has followed in providing financial assistance to member countries has relied on conditionality as the implicit price borrowers pay rather than the explicit price of market interest rates and collateral that the ESF adopted and that White did not lay down as the rule of action by the IMF. From the point of view of the borrower, conditionality is an implicit interest rate over and above the explicit rate charged for a loan. From the IMF viewpoint, conditionality should not be treated as a cost by the borrower. Fulfillment of conditions would improve economic performance.[12]

One objection to conditionality is that the IMF does not uniformly and predictably enforce its conditions. Some of the reforms the conditions exact are not in any event achievable over the duration of the loan. Another objection is that the number of conditions the borrowing country is asked to accept is so multifarious that, with the best will, making the required changes is beyond its ability to achieve. Indonesia, for example, was given a list in excess of 100 conditions when the IMF negotiated the loan it extended in 1997. Compliance was poor.

Some critics of IMF conditionality terms believe that conditionality should "require a country to do things that it does not want to do " (Williamson 2000, p. 13). On this view, conditionality is a device to ration access to cheap IMF credit. If all the IMF required a borrower to do was the continuation of past sensible policies, it would be overwhelmed by loan requests.

One way for the IMF to avoid this dilemma would have been for it to lend on the terms that the ESF observed. The amount that a country borrowed would be available at a market rate of interest backed by collateral. No intrusion into the country's institutional and legal

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[11] For discussion of subsequent developments in conditionality, see Polak (1991),James (1995, p.765);(1996, pp.322 ff.); Guitian 1995).

[12] Peter Kenen has suggested to us that conditionality should not be thought of as a substitute for the interest rate on a loan but as a substitute for collateral in order to insure that the loan would be serviced and repaid.

arrangements would be part of the IMF's mandate. The borrowing countries would seek assistance only if they were willing to meet a market test of their creditworthiness.

One may speculate about White's reasons for rejecting the idea of collateral to backup IMF loans. Was he concerned about enforcement of collateral requirements? No problem of this nature arose with ESF stabilization loans to Mexico, Brazil, and China. Did he believe that demanding collateral violated national sovereignty? It may well be that he regarded a demand for collateral as inconsistent with the notion that the postwar world should be built on foundations of trust and cooperation among countries. Collateral smacked of distrust.

4.2 IMF as a Lender of Last Resort on Commercial Terms

Harry Dexter White did not conceive of the IMF as a lender of last resort, although J. M. Keynes, its other architect, did. However, the idea was revived by the present first deputy managing director of the IMF, who has proposed that it could well function as a lender of last resort. The first deputy managing director's proposal includes provision of collateral by the borrower.

Recent reports on the future role of the IMF tend to agree that it is needed to address liquidity crises (Williamson 2000). What is at issue is on what terms it should provide liquidity to international capital markets that temporarily for whatever reasons are frozen. There is a longstanding prescription for central bank action when confronted by a national liquidity crisis: lend freely at a penalty rate on asset collateral that would be sound under normal conditions.

If the IMF were transformed along the lines of the forgoing prescription, it would cease to function as the institution that offers cheap credit to countries in trouble that White had in mind and instead would become a lender with strict standards in conformity with the demands of market discipline. Both the IMF and the borrowing countries would be constrained to alter their mode of operation. Instead of fifty years and more of IMF solicitude for emerging market

countries, their progress to developed country status might have been achieved more consistently had the IMF been a tougher disciplinarian.[13]

4.3 Deposing the Fiction that All Currencies Are Equal

White transferred from the ESF to the IMF the form of exchange of currencies of the two contracting parties and not loans by one party to the other, to avoid "the indignity that might seem to attach to borrowing" (Gold 1988, p. 1127). This rhetoric falsifies the actual transaction of a stabilization loan by the ESF and lending by the IMF to client governments. When a member borrows from the IMF, the rhetoric states that it buys currencies of other members (or SDRs), paying the equivalent in its own currency. When the member repays the credit, the rhetoric states that it repurchases the IMF's holdings of its currency with SDRs or other members' currencies. The fiction fosters the idea that the borrower has not assumed a debt. Going into debt becomes behavior that a country need not restrain. What matters in this culture is emphasis on the availability of funds, not on whether it is in the best interest of a country to be a borrower. The culture encouraged the piling up of indebtedness in some countries and the extension of IMF credit year after year in others (see, for example, Bordo and Schwartz (2000, Table 2). This may also reflect the fact that until 2000 the IMF had no formula for forgiving loans.

This obscurantism is reflected in the balance sheet of the IMF, which does not provide usable information on the actual transactions between the IMF and the member country (Polak 1999). The assets side, for example, does not include an entry for loans to members. What it shows is the total amount of member country currencies that the IMF owns. There are other deficiencies of the IMF financial statement, related to the separation of the Fund's activities into

[13] This hypothetical statement of course ignores the issue that decades of IMF subsidized lending may have created so strong a constituency among the recipients as to prevent any significant move in the indicated direction.

two departments, the General Department and the SDR Department, but for our purpose, the important point is that the "currency veil" lacks transparency.

Had the doctrine not been transmitted from the ESF to the IMF, the latter's role could have been defined in a straightforward way as a lender on commercial terms to countries in need of financial assistance.[14]

5. Conclusion

We have highlighted the elements of the operation of the U.S. ESF that Harry Dexter White transferred to his plan for the operation of an international stabilization fund. The elements included the principle that all currencies were equivalent and the goal of the international fund, like that of the U.S. fund, was to stabilize exchange rates.

The ESF also influenced White's vision for the IBRD. To a greater extent, however, the latter institution evolved from the plans for the Inter-American Bank that did not see the light of day. The IBRD represented a reaction by White against key elements of ESF stabilization loans which were very short term, at above market interest rates, and required collateral. Had White carried forward to the IMF the ESF elements pertaining to interest rates and collateral, its operations would have evolved in a markedly different direction from the one that it has taken. An interesting question is, would the world have been better off?

[14] It is possible that the fiction was created to win approval of the Bretton Woods Articles by the U.S. Congress, as James Boughton suggested to us in private correspondence. It is also possible that, had the IMF been set up as a lender on commercial terms, it would have been opposed by U.S. and foreign commercial banks. However, there was virtually no private international lending when Bretton Woods was established.

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