(letterhead of)

FEDERAL RESERVE BANK OF NEW YORK
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June 19, 1944.

Board of Governors of the
Federal Reserve System,
Washington 25, D. C.

Dear Sirs:

On July 15, 1943, and on October 7, 1943, we sent you our views on International Currency Stabilization, and on the stabilization proposals which were then under discussion. In the intervening months we have continued to study this problem and, since its publication in April, we have concentrated our attention on the joint-statement by experts on the establishment of an International Monetary Fund. As a result of our studies, and discussions with the directors Committee on Foreign Relations, (including Mr. S. Sloan Colt, Chairman, Mr. Donaldson Brown, Mr. Carle C. Conway and Mr. Beardsley Ruml, members), and the board of directors, the enclosed statement has been prepared and approved as a general consensus of the present views of this bank on International Currency Stabilization.

We have in mind that the Board, in its letter of June 8, 1944, invited our comments on certain aspects of currency stabilization proposals and on the proposal for an International Bank for Reconstruction and Development. We hope that we shall be able to respond to these requests shortly.

Yours sincerely,

(signed) Allan Sproul

President.

P. S. For your convenience, additional copies of the statement are enclosed herewith so that each member of the Board may have a copy.

A.S.

June 19, 1944

INTERNATIONAL CURRENCY STABILIZATION

On October 7, 1943, this Bank sent to the Board of Governors a statement of its views on the proposals for international monetary stabilization then under discussion. On April 21, 1944, there was released in Washington and London a "Joint Statement by Experts on the Establishment of an International Monetary Fund," and on May 26th President Roosevelt issued a call for a formal international conference to meet at Bretton Woods, New Hampshire, on July 1st. In view of these developments, we feel we have a responsibility to state our present views. We have taken a deep interest in these proposals ever since the original American and British plans were published in April 1943, and our present views are the result of continuing study by our officers and staff, and of consideration which has been given to the problem by our directors Committee on Foreign Relations and by our Board of Directors.

We believe that enlightened American self-interest will require post-war international economic cooperation on many fronts. We believe that international currency stabilization, and an international institution to promote currency stabilization should play an important part in this cooperation. The present draft proposals, while evidencing much progress as compared with earlier drafts, do not meet the test of American self-interest and, taken as a whole, are disappointing in their approach to currency stabilization. Our main conclusion is that these defects are the product, or chiefly the product, of attempting a global solution of a problem which cannot be solved in this way at this time. The basic difficulty is that in signing a stabilization agreement now countries must preserve for themselves so much freedom to deal with the uncertainties of the period of transition from war to peace that any longer-run stabilization plan can be one in name only. Our view, therefore, is that the forthcoming international conference should postpone consideration of the monetary plan for the longer-run period, except to create a consultative body, and should concentrate on measures for the transition period designed to produce those more normal conditions in which currency stabilization can be considered with a better prospect for success.

As we have said, the present statement of principles is in some ways a marked improvement on earlier draft proposals. It recognizes the distinction between the transition period and the longer-run; it retains exchange control for the transition period; it provides for greater exchange rate variability. These are three major constructive steps, although all three would need further definition.

We have particularly emphasized our view that a currency stabilization fund should not be used to finance relief, reconstruction, or the liquidation of indebtedness which has been accumulated during the war, and the new draft proposals expressly provide that the fund is not intended to be used for these purposes. But we would still insist that plans for meeting the needs of the transition period must come first. If this is not done the currency plan might be the catch-all for any inadequacies of the transition program and thus run the risk of being wrecked in the early years. If the special needs of the transition period and the proposed monetary fund exist side by side, it will almost inevitably lead to a confusion of the short-run problems of transition from war to peace with the long-run requirements of currency stabilization.

Fortunately it is now accepted that an international monetary fund is not needed to avoid currency chaos in the transition period. The retention of exchange controls in the new statement of principles is a recognition of this fact and a necessary consequence of the decision that the fund should not be used to finance the special requirements of transition. We approve of this change, and have argued that exchange controls should be the main reliance for exchange stability in the transition years, and can be relaxed only carefully and gradually. The present statement of principles leaves more uncertainty, however, than seems to us desirable in an international compact as to when free exchange convertibility, at least by the major countries, will be resumed. The Explanatory Notes released by the British experts, to accompany the publication of the text of the statement in London, explain that while member countries must consult with the fund within three years about their exchange controls, and the fund may within that period suggest that the time has come for further withdrawal of restrictions, "no member is committed to any fixed date for their final removal and is entitled to use its own judgment as to when it is strong enough to undertake the free convertibility of its currency which it has accepted as a desirable aim." On this interpretation, exchange controls and even bilateral agreements could be continued for an indefinite period. This indicates again, in our judgment, the need for concrete plans for the transition period before any longer-run monetary agreement can take definite shape.

One question, for example, is whether in the liquidation of the balances that have accumulated in London during the war, which must by now amount to approximately $8 billion, the British may not feel impelled, unless some funding arrangement is made, to continue exchange controls, and even bilateral agreements with some of the countries to whom these balances belong. That has been the history of blocked balances in the past, and in view of the large amount involved the policy might in this case persist well beyond the three-year period. It would be unfortunate if the major countries, while indicating adherence in principle to multilateral trading in a free exchange market, should with official international sanction carry on indefinitely and perhaps for a prolonged period, policies and practices which run directly counter to those principles.

The section on exchange rates is, perhaps, the most significant part of the new draft. No satisfactory proposal for fixing a large number of exchange rates, under present or immediate post-war conditions has yet been advanced, nor do we think one can be advanced. We favor the provision of greater exchange rate variability than was provided in the earlier drafts. The period of relaxation of exchange controls will probably be particularly difficult and require considerable adjustment of exchange rates. As we saw in the twenties, after a great war the previous exchange rates are largely meaningless, and what is required is not only substantial latitude in finding new equilibrium rates but close and sympathetic international consultation and cooperation in the process. It is entirely understandable also that Britain and other countries should require that "domestic social and political policies" should be taken into account while this process of adjustment is taking place. Even after new equilibrium rates have been found, there may well be occasions when further adjustments of exchange rates will seem the most reasonable and desirable method of international adjustment. But these variations must not be resorted to so often or be pushed so far as to submerge the principle of two-sided international adjustment, through the use of external and internal corrective measures, which is the foundation of a workable international monetary standard.

One of the greatest weaknesses in the earlier plans, in our judgment, was their sketchy treatment of the corrective measures to ensure stability. In the present statement of principles this weakness stands out strikingly. It would seem that the experts have gone carefully through it and struck out every reference which might seem, expressly or even by implication, to require corrective adjustments to preserve stability of exchange rates. As we interpret the present draft, exchange rate variation is not merely a permissible method of adjustment under appropriate circumstances but is to be the favored method. That this is the interpretation which the British place upon it themselves is indicated by the comments in the British press and Parliament, and most notably by Lord Keynes in his statement to the House of Lords on May 23rd:

> "In fact, the plan introduces in this respect an epoch-making innovation in an international instrument, the object of which is to lay down sound and orthodox principles. For instead of maintaining the principle that the internal value of a national currency should conform to a prescribed de jure external value, it provides that its external value should be altered if necessary so as to conform to whatever de facto internal value results from domestic policies, which themselves shall be immune from criticism by the Fund. Indeed, it is made the duty of the Fund to approve changes which will have this effect."

We doubt, however, whether even this statement by Lord Keynes completely describes the British interpretation of the new proposals. The draft contains also a section on "scarce currencies," which has been widely commented on in the British press. This section obviously has particular reference to the dollar. Both the earlier American and British plans had attempted to deal with this problem through corrective action by the creditor country, but now this provision is dropped, and in its place it is provided that whenever the dollar is scarce the countries affected may "restrict the freedom of exchange operations" in dollars and that in determining the manner of restricting the demand and rationing the limited supply of dollars among their nationals, they shall have complete jurisdiction. British comment has made it clear that the purpose of this change is to put the onus of international adjustment upon the United States. This is entirely in keeping with the British view, steadfastly maintained from the beginning of the discussions, that the gold standard method of adjustment was one that worked one-sidedly, through adjustments by the deficit countries, and that what is needed in the future is a method of adjustment which will put the responsibility exclusively upon the creditor country. The British have made it clear that the new statement of principles, in their view, contemplates an international agreement to this effect, supported by official sanction to resort to whatever measures they may select in order to prevent any part of the burden of adjustment from falling upon them.

It is our belief that the essential principle of monetary stabilization is two-sided adjustment, through external and internal corrective measures, at reasonably stable exchange rates in a free exchange market. We recognize the need for modifying this principle at particular times and in particular circumstances. We recognize that the degree, character, and occasion for the use of these modifications constitute the crux of the problem, and that the considerations involved are so difficult that there may well be grounds for differences of emphasis. We are far from wishing to identify ourselves with the extreme view held by some sections of American opinion that currency stabilization requires the straight-out restoration of the gold standard of earlier years. But neither can we accept the extreme opposite view, which seems now to be the official British view. Even less can we accept the view that in so far as international adjustments are to be made, by methods other than exchange rate variation and exchange control, they must be made through one-sided action by the creditor country.

We believe, therefore, that it would be a great mistake for the United States to give adherence to an international agreement which the British interpret in this fashion. In our judgment, far from having a stabilizing effect upon currencies and an expansive effect upon world trade, it would lead to endless recrimination, would saddle us with the sole responsibility for international maladjustments, and quite possibly, in the end, for the breakdown of the plan itself. This would be in the best interests neither of the United States nor of the world.

There are other questions concerning these recent proposals for an international monetary fund which we need not discuss here, because of our more fundamental objections, and because these questions largely grow out of the attempt to create a fund before the needs of the transition period have been met by more satisfactory means. There are such questions as the size of the fund, the substantial control of the fund by debtors although it is primarily a credit-granting institution, and the use of quotas to determine in advance the amount of a country's need, with its accompanying right to borrow.

We cannot avoid the conclusion that, as regards currency stabilization, the attempt is premature. What is first needed is a more concrete program for dealing with the problems of the transition period, a program designed to produce those more normal conditions in which an international currency stabilization fund can be established with a better prospect for success. These transitional problems comprise expenditures for relief and reconstruction, some plan for dealing with sterling war balances, and at a later stage the steps to be taken in relaxing exchange controls. In connection with these problems it will be desirable to devise special means of extending international credits and to provide machinery for international consultation which would help to make the problem of finding equilibrium exchange rates an orderly and non-competitive process. And it may well be that out of this experience there could develop a genuine stabilization program.

We still believe, however, that the actual process of stabilization must be one beginning with a few of the major international currencies, tying in the lesser currencies as conditions warrant. In particular, attention should be given the dollar-sterling rate and the international financial position of the United States and Great Britain at the close of the war. This is a matter which it would seem to us can best be pursued by these two countries, having regard for their own interests and in the light of their responsibilities to the rest of the world, rather than a matter for determination by an international fund. We have stated our view (in our earlier memorandum) that, at the close of the war, the international position of Great Britain will be badly unbalanced on current account and that there will be a very large volume of foreign funds blocked in her markets which will gradually have to be unfrozen. We have also stated that the obvious course for the United States to pursue, as the principal creditor nation of the world, as the prospective associate of Great Britain and other principal powers in maintaining world peace, and as a country desirous of expanding world trade, is to help restore Great Britain to a position of balance in her current accounts. This we have said is an international action of concrete, constructive and comprehensible character which will at once benefit ourselves, Great Britain and other countries, and is more likely to appeal to the American people than attempting to deal with it, in whole or in part, anonymously through an international fund.

The British experts apparently have not been receptive to such direct arrangements. They are evidently afraid that we shall not be able to exercise a measure of control over our economic life so as to avoid severe booms and depressions; that we shall permit our international accounts to get out of balance by not importing enough goods and services or lending enough abroad, and that to link sterling with the dollar may be to expose their domestic economy to violent and unnecessary ups and downs which they believe they can otherwise avoid.

Admittedly, one of the chief uncertainties of the transition period is the maintenance of high production and employment in the principal countries. Obviously these uncertainities have played a major role in shaping the British attitude toward plans for currency stabilization. But our own domestic program presents no less uncertainty for us than for them. If, in addition to finding solutions for some of the abnormal international problems of the immediate post-war years, we could have a demonstration in both countries of their ability to achieve and maintain economic stability at a high level of national income and employment, it seems practically certain that much of the fear of international currency stabilization which characterizes the present joint draft might be allayed and that a genuine stabilization fund could then be developed.

Despite the fact, therefore, that negotiation and present plans have advanced a considerable way, we think it fortunate that our Government is not yet committed to them. And we feel it an obligation to repeat our suggestion that, in a world in transition from war to peace, the first step toward international currency stabilization should be to establish a direct working agreement with Great Britain looking toward:

1. Achieving and maintaining internal stability and a high level of production in these two principal commercial nations. Great Britain has already published a white paper discussing British plans for this purpose. Various Government agencies and private groups have been working on this problem in the United States, but apparently not with the energy which has been devoted to international monetary problems, and with inadequate liaison between the agencies and groups.

2. Achieving and maintaining stability of the dollar-sterling rate. This would involve considerable freedom in seeking an equilibrium rate in the transition years, and would not mean rigidity in the later years.

Other countries could adhere, at its inception, to whatever currency stabilization agreement is developed or later as their circumstances would permit.

What can be done now in a wider field of currency stabilization is to set up an international consultative body, which would establish the principle of continual consultation on exchange rates and other monetary matters; which would collect and disseminate information; which, perhaps, could help to arrange credits through stabilization funds or central banks, where necessary to care for temporary disequilibria in payment balances; and which would form the basis for an international stabilization fund to be established when it has a reasonable prospect of successful operation. The real borrowing and lending problems of the transition period and the longer-run problems of currency stabilization should not and need not be mixed, and international currency chaos is not a danger so long as exchange controls exist.

In reaching the various conclusions which are presented above we have considered carefully the view that the only time, if ever, nations will agree upon an international currency stabilization plan is during the war before the desire for cooperation has evaporated, and that it is, therefore, better to adopt the presently suggested plan rather than none at all. We do not believe these are the alternatives. There is an inherent contradiction involved in appealing to the spirit of wartime cooperation as a basis for an agreement which, as it stands, is an agreement upon national freedom of action in the post-war period. And yet we entirely understand why in the face of the many and great uncertainties, both domestic and international, that lie between the present and the more normal conditions which are the essential prerequisite for international monetary stabilization, nations should feel disposed to insist upon freedom even to the extent of submerging basic principles. The lesser urge to cooperate later on must be measured against the lesser hazards involved. Meanwhile, the possibilities of international economic cooperation in other and more important directions still lie open.

The pressing need now is to provide the special kinds of international credit which will be effective and useful in the transition period, assuming that other and important questions of international political and economic collaboration will also be under development. We suggest, therefore, that the forthcoming international monetary conference should not try to proceed with the establishment of the international stabilization fund outlined in the joint statement of experts, but that it should address itself vigorously to the development of means and methods of providing the special lending and borrowing facilities needed during the transition from war to peace. The monetary conference could also prepare plans for an international consultative and cooperative body which would help to make the process of finding equilibrium rates of exchange during the transition period an orderly and non-competitive process. Meanwhile, the United States and Great Britain should jointly re-examine their international financial position with a view to facilitating the unfreezing of the British blocked balances and the stabilization of the dollar-sterling rate as a nucleus of international currency stabilization; and should explore the possibility of parallel programs of internal economic stability at a high level of production. These suggestions recognize the need for international economic cooperation, but they also recognize the danger of premature proposals for the creation of an international currency stabilization fund which risk rejection, or failure in operation, either one of which would seriously endanger the cause of international collaboration.

Federal Reserve Bank
of New York