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W- Eccles

FEDERAL RESERVE BANK OF PHILADELPHIA

Office of the
President

June 26, 1944

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

Dear Sirs:

The proposed plan for an International Monetary Fund has been reviewed by our Board of Directors and Officers, as requested in your letter of June 8, 1944, with special reference to the effects that this Fund might have upon our domestic economy and the problems that might arise for the Federal Reserve System. The Board has appointed a committee, consisting of Messrs. C. Canby Balderston, Howard A. Loeb, and James T. Buckley, to consider the plan and its implications.

General Attitude

We believe that it is to the interest of the United States to foster international economic collaboration and the establishment of adequate machinery to deal with post-war problems. Heavy costs cannot be escaped by refusing to cooperate.

To succeed, an international plan dealing with exchange rates or other aspects of post-war problems must be based on mutual trust, understanding and willingness to undertake and carry out obligations by all participating countries.

The principles and objectives of the proposed plan provide a basis for working out the appropriate form, policy and program for an International Monetary Fund. It is desirable to develop and adopt a suitable plan as soon as possible.

Clarification of the present plan needed

The proposed plan for an International Monetary Fund raises three sets of searching questions:

1. What does the plan mean positively and negatively to the United States and other countries?

Is the position of the United States made clear at home and abroad?

II. What is the total obligation of the United States likely to be under this plan and under the proposals relating to long-term lending, and relief and rehabilitation?

What potential strain may be imposed upon our banking system and what is its ability to withstand it?

III. Are the safeguards now provided in the plan adequate to protect the interest of the United States as the largest creditor country?

Comments

I. It would be desirable at this advanced stage of the discussion to interpret various provisions of the plan and their implications for the participating countries. Such interpretation is particularly important in those countries where acceptance of the final plan depends upon popular support.

The position of the United States must be made clear. Lack of adequate interpretation has already raised some doubts and reservations abroad. The prevailing attitude of many editors, economists, bankers and legislators at home has been generally unsympathetic. There seems to be no valid reason for failure to give appropriate information to the public at this time.

II. Early estimates should be made of the possible total obligations that may be imposed upon the United States through its international economic collaboration. While it is difficult to make such an over-all estimate at this time, some general approximation may be obtained on the basis of the present proposals for currency stabilization, long-term lending, and relief and rehabilitation.

Any such approximation, of course, should be related to the resources of the United States. Commitments of the magnitude contemplated under the proposals will inevitably place a considerable strain upon the economy of this country, particularly its financial system, and create many difficult problems of practical administration.

It is certainly desirable to have some idea as to the potential amount of credit balances that the United States might acquire in the event other countries draw upon their quotas in the Fund to the limit, so as to approximate the maximum strain that may be placed upon the Federal Reserve System. Because of our monetary responsibility, it may be necessary to insist that some participation, direct or indirect, be given to the Reserve System in the management of the Fund even if it is only to guide this country's representative on the Board of Directors and the Executive Committee.

In addition to the manner in which our contribution is to be paid, the actual operation of the Fund is bound to have expansionary effects on the reserves of our banking system, at least during the period of transition and rehabilitation. If our bank reserves should further expand to any large extent under the impact of the Fund, does the System at present have adequate powers to absorb additional reserves? If not, should it ask for them now or after the plan has been finally accepted?

Implications like these are significant to the Reserve System and our domestic economy. The questions they raise will have to be answered, especially when legislative approval of the plan is required.

III. How adequately is the interest of the United States protected under the proposed plan? This question calls for several specific comments.

First, are the present provisions adequate to induce non-cooperating member countries to live up to their agreements? The plan is designed to give to an international body a measure of influence over the internal policies of the individual countries. What if some of these countries choose to resist directly or indirectly any interference in their domestic affairs from the Fund? Strong reservations are already voiced in Great Britain. In his address to the House of Lords on May 23, 1944, Lord Keynes, a British principal spokesman, stated:

> We are determined that, in the future, the external value of sterling shall conform to its internal value as set by our own domestic policies, and not the other way around. Secondly, we intend to retain control of our domestic rate of interest, so that we can keep it as low as suits our own purposes, without interference from the ebb and flow of international capital movements or flights of hot money. Thirdly, whilst we intend to prevent inflation at home, we will not accept deflation at the dictate of influences from outside. In other words, we abjure the instruments of bank rate and credit contraction operating through the increase of unemployment as a means of forcing our domestic economy into line with external factors.

Other member countries undoubtedly will advance similar reservations to safeguard their freedom of action in managing domestic economies. In the face of such reservations, can the Fund exercise its proper influence? What will be our position and responsibility in managing the Fund, especially since under the plan the external value of various currencies may have to be adjusted to their internal values instead of the other way around?

> States Lord Keynes: A proper share of responsibility for maintaining equilibrium in the balance of international payments is squarely placed on the creditor countries... The Americans, who are the most likely to be affected by this, have, of their own free will and honest purpose, offered us a far-reaching formula of protection against a recurrence of the main cause of deflation during the interwar years, namely the draining of reserves out of the rest of the world to pay a country which was obstinately borrowing and exporting on a scale immensely greater than it was lending and importing.

This is pointed, and perhaps rightly, at the United States and in effect means a demand for a substantial reduction in tariff or a drop in our export trade or unlimited foreign lending or a combination of all of these. Unless the ground is thoroughly prepared for the acceptance of this interpretation, how would this version by the British spokesman be received by our legislators and the public? Moreover, failure to change our national policies might result in attempts to place the blame for the downfall of the plan upon the United States.

Second, the plan apparently permits Great Britain to retain her wartime restrictions and special arrangements with the Sterling Area and others during the transition period of undefined duration. This privilege obviously will strengthen the international bargaining power of the British Empire greatly. What safeguards should be provided to protect or sustain the trading position of the United States with its high stake in maintaining equilibrium in exchange rates?

Being impoverished and having learned how to use monetary controls in their domestic affairs, will other nations really attempt to stabilize their currencies? Under the pretext of correcting "fundamental disequilibrium", some nations might devaluate their currencies to the permissible maximum and then withdraw from the Fund. They could then assume an attitude of "wait-and-see", jockeying themselves into positions to bargain with the principal countries. The influence of the Sterling Area and its extension to South America might encourage such an attitude to our commercial disadvantage.

Third, if a serious lack of equilibrium in international trade developed and persisted while the plan was in operation, the Fund would accumulate increasingly larger amounts of the currencies of the weaker nations, whereas its holdings of the currencies of the stronger nations would decline. When the weaker nations had exhausted their "lines of credit", they could no longer make full use of the Fund. What remedy does the plan provide to safeguard currencies and gold of the stronger nations?

Fourth, some effective means should be provided for speeding up the repayment of temporary indebtedness, since the primary purpose of the Fund is to tide the borrowing country over temporary emergencies, not to extend time credit. The usual commercial banking method of imposing interest charges is hardly applicable to this type of operations. A country without immediate financial resources and in need of goods should be given an opportunity to borrow medium or long-term funds, rather than be permitted to use the funds designed for temporary adjustment to hold its currency in equilibrium with other currencies. It is, therefore, urgent to set up machinery to facilitate the flow of long-term capital at the same time that a plan for orderly and systematic adjustment of exchange rates is adopted.

Fifth, corrective measures should be devised to prevent wide fluctuations in exchange rates, creating risks which tend to restrict trade, induce speculative movements of capital, and otherwise produce dislocations at home. Absolute rigidity of rates, of course, may be equally harmful if maintained in the face of sweeping changes in internal and external conditions. Present provisions in the plan appear to be somewhat vague with respect to both exchange controls and restraints on disturbing capital movements.

Sixth, definite provisions should be worked out for the liquidation of blocked currencies throughout the world. These frozen balances in the aggregate are large and may be so used as to deter rather than promote international trade and stability of exchange rates. Specific arrangements should be worked out for funding these currencies if exchange controls are to be effective.

Seventh, the provisions for fixing par values of such a large number of exchange rates under present and prospective conditions should be more carefully worked out than at present, as in the end it is of utmost importance to establish proper new equilibrium rates. The present provision for adjusting currencies to correct a "fundamental disequilibrium" does not seem adequate. It is important to establish the responsibility of the country seeking to correct its domestic maladjustments, so as to assist the Fund in maintaining a reasonable degree of exchange rate stability.

Finally, such other phases of the plan as those relating to the size of the Fund and its purposes, the control over it through voting, and the basis for determining quotas should be clearly spelled out at the outset to avert future recriminations. The interest of the United States should be amply protected in view of its great share of responsibility for the proper functioning of the Fund.

We trust that the foregoing observations may be helpful to Chairman Eccles as a member of the American delegation. Our Directors and Officers desire to express their appreciation for the opportunity to review this subject. All of us wish Mr. Eccles successful participation in this important undertaking. We fully realize that his responsibility is very heavy indeed.

Sincerely,

(Signed) Alfred H. Williams

President