

6/12/45

ANSWERS TO QUESTIONS WHICH MAY BE RAISED
AT THE SENATE HEARINGS ON BRETTON WOODS

Questions on the Bill

1. Will Section 13 of the bill, which gives the Bank power to make loans for programs of economic reconstruction and the reconstruction of monetary systems, including long-term stabilization loans, help to prevent the Fund from being frozen up in long-term credits?

Answer: The C.E.D. proposal incorporated in Section 13 is an excellent one. There are cases in which individual foreign countries need assistance to carry out general reconstruction programs, rather than to undertake the kind of specific projects of reconstruction or development which the Bank is expressly empowered to finance. The clarification of the Bank's power to make loans in such cases, as contemplated in Section 13, is desirable. Pressure on the Fund for long-term assistance will be reduced if the Bank finances not only specific projects but general programs involving large purchases abroad.

2. Will interpreting the Fund's authority as limited to affording temporary assistance to members in connection with seasonal, cyclical, and emergency fluctuations in the balance of payments, as suggested in Section 14, help to ensure that the Fund's resources will not be used for long-term financing?

Answer: Yes. Section 14 is in accordance with the spirit of the Fund proposal but it states more clearly than in the Agreement the temporary character of Fund assistance and makes certain that the great influence of the American representatives on the Fund will be used to prevent one-way use of its resources by countries that are not taking adequate measures to correct their international deficits.

3. Should any further clarifications be proposed, for example limiting the Fund's assistance to a definite period of time?

Answer: Further clarifications are unnecessary. It would be a mistake to limit the Fund's assistance to a fixed period. The difficulties faced by a country which is getting assistance from the Fund may last two or three years, and in some cases even longer. If the country is taking adequate corrective measures, the Fund should not be forced to cut it off suddenly from further assistance just because a fixed period is up. It should be able to see the country through to full recovery.

4. Should the Export-Import Bank be given additional lending authority even though the Fund and Bank are accepted? If so, what should be the principal functions of the Export-Import Bank?

Answer: The lending authority of the Export-Import Bank must be expanded. Even if the Fund and Bank are put into operation as quickly as possible they will probably not be functioning very actively until the middle of 1946. This is one reason why the Export-Import Bank needs additional funds. There are tremendous reconstruction needs to be met in the coming year. Furthermore, even with the Fund and Bank in operation, the United States will have a special

interest in financing certain projects, for example in Latin America, which the International Bank may not have the resources to finance or may not wish to finance because the beneficial effects of the project will be confined largely to promoting trade with the United States.

5. Is the National Advisory Council established in this bill in line with the recommendation of the Board of Governors in its statement of March 21, 1945?

Answer: Yes. In some respects it goes even farther. The Board of Governors did not suggest that the Council coordinate the activities of all agencies engaging in foreign financial transactions but such coordination is undoubtedly a good idea. The powers implied in the authority to "coordinate" the activities of such agencies should perhaps be clarified. Also provision might be made for regular meetings of the Council with the American representatives on the Fund and Bank and with the heads of agencies engaged in foreign financial transactions.

Questions on Effects on the United States

1. How would the Fund and Bank help to moderate disturbing influences on this country's monetary and credit structure as was suggested in the Board of Governors' statement of March 21, 1945?

Answer: The Fund will help to promote balance in the international transactions of all members, including the United States, and therefore will moderate any tendency for large gold flows to this country. The Fund will also help to maintain foreign trade at a high level and prevent the large fluctuations in our exports which have added to inflationary or deflationary pressures in the past. The Bank will also help by promoting sounder and more stable foreign lending on the part of the United States. In the 1920's a wave of foreign lending followed by an abrupt cessation of foreign lending was an important factor in the complete disintegration of the world's monetary system and world trade.

2. Why should we finance an export boom when we will be short of goods in this country?

Answer: As long as certain essential goods are in short supply we will certainly have to screen our exports to make sure that shipments abroad are not any larger than necessary. Unless controls are relaxed too soon, there will be adequate safeguards against loans to foreigners enabling them to take goods out of this country that we can not spare. Loans will be necessary, however, to ensure that no country will be prevented by inadequate funds from purchasing the goods allotted to it. It is in our own interest to help foreign countries get back on their feet as soon as possible so that they may become good customers and good sources of supply.

3. Will not the Fund and Bank have an inflationary effect in this country?

Answer: The danger of inflation in this country will not be seriously affected by loans made through the Fund and Bank. The volume of domestic

purchasing power which may press on our supplies if controls are relaxed too quickly is so great that the two or three billion dollars a year maximum which might be made available to foreigners through the Fund and Bank is relatively insignificant. Furthermore, under the Bank we can decide in each case whether dollar loans should be granted or whether securities should be floated in this market. We can prevent large amounts being made available to foreigners when there are inflationary dangers and can promote foreign lending in periods of unemployment and deflation.

Questions on the Bank

1. If the United States lends abroad in large amounts through the Fund and Bank and other institutions, isn't it going to be impossible for foreign countries to service the loans because the United States will not be willing to take payment in terms of goods?

Answer: Loans made under the auspices of the Bank will be carefully studied from the point of view of the ability of foreign countries to service them. All loans by the Fund and Bank will be aimed at helping foreign countries to balance their international transactions as a whole, including servicing of the foreign debts.

As far as the United States is concerned, there is every reason to believe that we will import more after the war. Exchange rates should be better adjusted than in the 1930's and if we are able to maintain a high level of income and employment our income will be large. Furthermore, if there is no abrupt cessation of American loans and if loans are made on reasonable terms the adjustment in our imports can be made very gradually.

2. Isn't it a mistake to lend abroad to help foreign countries develop their industries because they will eventually have no need for our goods and our exports will be sharply reduced?

Answer: The industrialization of foreign countries will tend to raise rather than lower the level of United States foreign trade. Our trade with highly industrialized nations like the United Kingdom and Canada is much greater and more profitable to us than our trade with poor undeveloped countries. Industrialization of backward areas will lead to rising incomes and enable them to purchase our goods.

3. Why should we put our money into the hands of a Bank controlled by borrowers instead of lending directly through an American institution?

Answer: The Bank definitely is not controlled by borrowers. Each country has important veto powers over the use of its own subscription for making loans and over any securities floated in its markets. The United States can see that dollar loans are made at times when they will not have harmful effects in this country and for projects which are in our interests. The advantage of the International Bank for this country is that all members share the risks involved.

Questions on the Fund -- Why Set up a Fund

1. Why should we have two institutions, a Fund and a Bank?

Answer: The Fund and Bank were set up as separate institutions because they really have distinct functions to perform. The types of experience and knowledge needed by administrators of the two institutions will be quite different. The Bank will make or guarantee loans for long-range development and reconstruction projects. It needs men familiar with the technical, engineering, and economic problems arising in connection with such projects. The Fund deals with deficits in the balance of international payments. It gives temporary assistance to countries in exchange difficulties and needs men with experience in international stabilization operations and foreign exchange problems. It seems just as important that the Fund and Bank be separate institutions as that certain institutions in our own country confine themselves to commercial banking activities and others to long-range investment activities. It is important, however, that the Fund and Bank work together and coordinate their policies and operations.

2. Why not just stabilize the key currencies?

Answer: The Fund proposal incorporates any advantages which may be claimed for the key currency approach and has many advantages that can not be claimed for that approach. The dollar-pound rate will be set at an early stage and other countries will set their rates in relation to the pound or the dollar by a process of international agreement. The rates established in this way will be more appropriate than rates established unilaterally. Each country will promise not to alter its rate except after consultation, and to eliminate exchange restrictions and the Fund will help them live up to these promises. The key currency approach provides simply for each country setting its rate and for large loans by the United States to Great Britain and others. Britain has no interest in saddling herself with huge dollar debts.

3. Why should we set up a Fund at all when other countries have plenty of gold and dollars?

Answer: Although many countries have large gold and dollar balances there are many others whose reserves are clearly inadequate. Of the 44 countries represented at Bretton Woods 22 have gold and dollar reserves equal to less than 50 per cent of their exports in 1929 and these 22 countries have 2.5 billion dollars out of the total of 6.1 billion dollars of foreign quotas. Furthermore, even countries with large gold reserves have a substantial proportion of their gold tied up in meeting domestic reserve requirements.

4. Why not just go back to the gold standard?

Answer: There is no possibility of going back to the gold standard. Some of the major countries, including the United Kingdom, would not consider it because of the difficulties they have experienced under the gold standard. Efforts to maintain absolutely fixed exchange rates in the twenties resulted in deflationary pressures spreading from one country to another. The Fund retains the idea of establishing the values of all currencies in terms of

gold, however, and all members promise to maintain the rates established unless a change is necessary and is approved by the Fund.

Questions on the Fund -- Exchange and Trade Controls

1. What good is it to have a Fund which does not solve Britain's problem or the problem of blocked balances?

Answer: Although the problem is important and its solution is a desirable objective it is clear that Britain cannot eliminate the blocked balances all at once. Some long-term funding arrangements will be necessary and Britain has indicated that she prefers to make such arrangements with countries owning the blocked balances. A large dollar loan to Britain would not of itself help very much to solve Britain's problems, or the world's problem of establishing a sound post-war pattern of international payments and Britain has indicated she is not interested in getting such a loan. It would simply burden Britain with a dollar debt and make no real contribution toward balancing Britain's international payments. On the other hand, the Fund and the Bank, by providing the favorable conditions necessary for expanding world trade and investment, would be of real help in establishing a sound post-war pattern of international payments and contribute substantially to Britain's ability to balance her current transactions and gradually eliminate the blocked balances.

2. The Fund does not eliminate exchange controls in general as it pretends to do and, in fact, members are allowed or encouraged to control capital movements which means controls over all foreign exchange transactions.

Answer: Members of the Fund agree not to impose new controls without the approval of the Fund and to eliminate existing controls as soon as possible. It would be unwise and altogether impossible for some countries to remove all their controls at once.

The fact that the Fund allows controls over capital transactions does not mean that members are thereby allowed to control or restrict all exchange transactions. Members may have to supervise or license all exchange transactions but they are definitely prohibited from restricting payments for trade and services.

3. The Fund does not eliminate one of the worst forms of economic warfare, trade controls.

Answer: The Bretton Woods Agreements do not pretend to solve all international economic problems. They confine themselves to monetary problems. Member countries are not bound by the Bretton Woods Agreements to relax existing trade restrictions, or to refrain from the imposition of new ones. Therefore, it is certainly of the utmost importance in the interest of an expanding world trade that an international understanding on trade controls be reached.

However, the benefits of the Fund Agreement must not be discounted. Trade controls are often imposed because the economic system of a country suffers from an unfavorable trade balance or a disequilibrium in the balance of payments on current account and is unable or unwilling to make the drastic adjustments in the economy which are necessary to restore equilibrium

in time. The fact that the resources of the Fund are available to a member country while it experiences difficulties and while it adjusts its economy, will substantially ease the pressure toward imposition of trade restrictions. Thus, it can be said that the Fund, while it does not eliminate the right of any country to impose trade controls, is designed to avoid some of the conditions which lead to the imposition of trade controls.

Questions on the Fund -- Exchange Rates

1. You can not stabilize exchange rates until countries stabilize their own monetary systems.

Answer: There is a constant and complex interaction between the two and stability must be sought on both fronts at once. The Fund recognizes, however, that the external value of a nation's currency can not be stabilized if that nation does not possess a reasonable degree of political and economic stability internally. It therefore retains the right to postpone exchange transactions with any member if the member's circumstances are such that they would lead to use of the resources of the Fund in a manner contrary to the purposes of the Fund.

Furthermore, if unstable conditions develop at a later stage the Fund may require a member to take the proper internal measures as a condition of further access to the Fund.

2. The Fund does not really stabilize exchange rates; large changes are possible even without the consent of the Fund.

Answer: Each country has a right to change its rate by a cumulative total of 10 per cent of the initial rate after consultation with the Fund. The Fund has the right to object to further changes. The changes permitted on a unilateral basis are not large and the right to make such changes will presumably be exhausted in the transition period. The right to change rates without approval by this moderate amount was considered necessary in view of the difficulties under which initial rates will be set and the difficulties of the transition period.

3. The British and Americans do not interpret the exchange rate clauses the same way.

Answer: On the question of stability of exchange rates the British have emphasized the flexibility permitted by the Fund and the Americans the stability which members are obligated to maintain. The British are especially anxious to avoid a repetition of their difficulties in the twenties in maintaining a fixed rate while the United States is more concerned about avoiding a repetition of the fluctuating rates of the thirties. This does not imply any basic difference of interpretation of the exchange rate provisions. Whatever problems of interpretation do arise can be worked out according to the procedure provided in the Agreement.

Questions on the Fund -- Safeguards Against Misuse and Scarce Currency Problem

1. Members have an automatic right to borrow large amounts from the Fund and the Fund is controlled by debtors so the Fund's resources are bound to be wasted especially in the transition period. The safeguards provided in the Agreement are inadequate.

Answer: Member countries do not have an automatic right to borrow large amounts from the Fund. They have some assurance once they are allowed to begin exchange transactions with the Fund that they can come to the Fund for assistance for certain purposes, under specified conditions, and up to certain limited amounts. Members must be using the Fund to make payments due for current transactions and must be taking advantage of the breathing spell afforded to take measures to correct their unbalanced situation. The Fund can refuse further assistance to members not using the Fund in accordance with these purposes and does not begin transactions with any country until it is in a position to use the Fund properly.

There are also a whole series of automatic controls limiting a member's use of the Fund. A service charge is paid on all transactions; an additional charge is levied on all use of the Fund's resources which increases with the amounts used and the time over which they are used; and members adequately supplied with reserves are obliged to use them at the same rate they draw on the Fund and to use part of any increase in reserves to repay the Fund.

As far as debtor control is concerned there is little doubt that the United States and other creditor countries will have a tremendous influence in the management of the Fund. The United States can withdraw at any time and get back its subscription in dollars. Since our withdrawal would make it impossible for the Fund to continue to serve a useful purpose other countries will surely give serious consideration to our views on the management of the Fund. Furthermore, the United States will have 28 per cent of the actual votes to begin with and her vote may rise as high as 35 per cent.

2. When dollars are declared scarce all other countries will discriminate against American goods, and the Fund will try to force us to lower our tariff. We will have to keep putting more dollars into the Fund.

Answer: If dollars are declared scarce by the Fund it is true that other countries will be allowed to discriminate against American goods. The essential thing to realize is that dollars are likely to become scarce in the Fund only if they are scarce in the world as a whole and when other countries would be bound to discriminate against our goods. Ordinarily the Fund will help to prevent the scarcity from developing, and if it does develop will help to limit the restrictions imposed by foreign countries.

The Fund has no power, if the dollar is scarce, either to force us to lower our tariffs or to force us to lend more dollars to the Fund. The United States retains complete control over its own actions in both of these spheres. The Fund may recommend a lowering of tariffs or may request a loan. It will be up to this country to decide whether to accept the Fund's recommendations. The existence of the Fund will undoubtedly make it clearer to most people in the United States that we can not go on selling abroad unless we also buy abroad or lend.

Notes

1. No attempt has been made to answer the questions which will be raised as to why silver was not given an important role in the Fund plan.
2. A number of questions were raised and answered in the course of the June 12 hearings which are not listed above. The summary of the hearings gives a detailed account of such questions and answers.

Board of Governors of the
Federal Reserve System
June 12, 1945