

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 22, 1944

To Chairman Eccles

Subject: Treasury's International

From Walter R. Gardner *WRG*

Monetary Fund proposal

Governor Szymczak has asked me to send you the attached memorandum before the meeting this afternoon. The first page of the memorandum gives the present status of the Treasury's International Monetary Fund proposal. You already have Mr. Goldenweiser's outline of the plan brought down to date on the basis of the latest discussions with the British. A copy of the joint statement on which we are trying to agree with the British will be available shortly. It has been necessary to make up a new copy in order to embody the latest statement of the American position.

Attachment

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

CONFIDENTIAL

OFFICE CORRESPONDENCE

February 2, 1944

To Governor Szymczak Subject: Status of White Fund discussions --
From Walter R. Gardner possible Board action

The technical discussions on the international Fund appear to be nearing their end. As a result of cables between the Americans and the British the area of disagreement between them is being eliminated; and it is possible that a cable which is now being prepared by the Treasury as an aftermath of a meeting of the American technicians the day before yesterday will be accepted almost in toto by the British.

Meanwhile the five-man Russian delegation is here. An initial meeting to determine procedure with them has already been held and discussions will get under way in earnest this Thursday. The procedure will be to discuss first the joint statement of principles, on which we are now nearly in full agreement with the British. Next the detailed American plan for a Stabilization Fund will be considered. Then the investment bank proposal will be discussed. The Russians have been told that we would like to get their comments all along the line; but it is apparent that the pressure at the moment is on the joint statement of principles. If full agreement on this can be reached among the key countries, the statement will be sent to all the United and Associated Nations and about a week given to them to indicate their reactions. Thereafter it will be published as a Joint Statement of the technical experts of the United and Associated Nations. The public reception to this statement -- particularly the attitudes of the various legislatures -- will determine whether it is appropriate to go forward with a formal conference. It may be that at this stage further changes will be proposed in the plan. Adoption of any of them would involve more negotiation; for it is understood that there must be full agreement at the executive level among the key countries on the instructions to the drafting committee before such a committee is set up and a conference called.

The point at which the Board will be called upon to state its position will apparently be reached when the question of publication of the joint statement arises, although the moment may come somewhat earlier after agreement with the British and Russians has been reached and before the statement is taken up with the remaining countries. In either case the Board is likely to be called upon to state its position within the next month or two.

Although nominally the discussions have all proceeded at the technical level and the Board is free to take any position it wishes, it is apparent that at this late stage of the negotiations there is very little room for change in the plan agreed upon. Insistence upon any major change now would be received with amazement by other departments of this Government and by other countries, who would want to know

why the suggestion had not been made much earlier when it would not destroy the fruit of many months of arduous negotiations. Should the Board consider, however, that the plan is fundamentally wrong, it is free to take this very serious step and withhold its support until such defects as it may see in the plan have been remedied.

Fund has a useful purpose

There appears to be no occasion for such action. The proposed Fund is essentially a device for giving countries a longer period in which to make their international adjustments and for putting pressure on them at an early stage to take advantage of this longer period to bring into play measures that will be effective internationally and yet prove consistent with the maintenance of full production economies at home. The longer period for adjustment would be provided by the resources of the Fund. Countries would be enabled to meet deficits in their balance of payments by drawing on the Fund in addition to utilizing such reserves of gold and foreign exchange as they may possess. Foreign countries now have about 15 billion dollars of gold and dollar exchange and the Fund would add another 3 billion of gold and dollars as well as a mixture of foreign currencies. Furthermore, the Fund's resources would be pooled resources which could be concentrated at any particular point of strain. Dollar for dollar they would be more effective than the 15 billion dollars of independent reserves scattered unequally among the various foreign countries. Hence the period over which individual countries could stand a deficit in their balance of payments without taking violent counter measures such as exchange depreciation or the imposition of direct controls or deflation of the domestic economy could be considerably lengthened by Fund action. If this period was properly employed to effect a gradual readjustment, the whole process would prove to be more orderly and more conducive to the maintenance of world prosperity than the helter-skelter action of the 1930's.

But would the longer breathing spell be so used? Or would it merely permit an unbalanced situation to become more seriously unbalanced with a greater collapse at the end? If it did, it would be worse for the country and for the Federal Reserve System in particular. We would have failed to solve the problem of the gold flow to this country -- we would merely have intensified the problem by adding to the 15 billion dollars of foreign gold and dollar exchange our own 3 billion dollar contribution to the Fund, thereby increasing the potential flow of international means of payment to the United States.

Its direct power to deal with international unbalance and the gold flow is slight

It must be admitted that the Fund as set up does very little directly to meet the problem of the gold flow. Most of the foreign reserves remain entirely outside the Fund, where they can be freely used to finance international unbalance whether the Fund approves or not. We have been able to persuade foreign countries to pool in the Fund only 1 billion of the 15 billion dollars of gold and dollar exchange that

they possess. The 14 billion dollar difference is the measure of their freedom to do as they please. But whenever reserves outside the Fund prove insufficient and countries are forced to draw upon the Fund's resources to meet an international deficit, direct pressure can be brought to bear to correct the situation. They can be required to introduce control over capital exports if these are causing the trouble; or, if the cause is a chronic adverse balance of trade, they can be required to eliminate it by any measures they choose to adopt. If all else fails, they may have to resort to exchange control in this sphere, too; for if a country has exhausted its independent reserves and the Fund withholds aid, the country's international transactions must balance.

These are the direct measures of control to which the British are gradually resigning themselves although they have tried hard to get them removed. They apply only when a country has to draw upon the Fund; they do not touch a country that can finance its deficit out of its independent reserves. And they apply only if a majority of the Fund's management votes for their application. The United States cannot have more than a 20 per cent vote in the Fund's management; and the other votes will have to come from countries which will have very little at stake in the form of gold and dollar resources pooled in the Fund. It is a question just how far foreign members will go in helping us to see that deficit countries do not make a chronic use of the gold and dollar resources that have been largely contributed by the United States. But the powers are there to protect the resources of the Fund if they are properly used.

But its moral influence may be considerable

While the Fund will have direct powers over the gold movement to this country only so far as its own resources are concerned, it will be in position to exert a very considerable moral influence over the whole range of international transactions. In this respect it will be similar to the Bank for International Settlements which derived its main significance not from its banking transactions but from the fact that it brought the monetary authorities of the world together in the presence of a staff which was continuously working on international problems. As compared with the B. I. S. the Fund will represent an evolution and an advance. Instead of confining itself to central bankers, it will bring together the monetary authorities of today -- the direct representatives of the respective governments. And its staff will undoubtedly be larger and more purposeful than that of the B. I. S. Its recommendations will carry greater weight unless they are offset by the modern tendency of countries to put their emphasis on freedom to pursue domestic expansion programs irrespective of their effects in the international field.

And its power over exchange rates and controls is clearly established

Furthermore, the Fund's direct powers with regard to exchange rates and exchange control are far more comprehensive than its power to enforce international balance. They are not limited in their application to countries that are using the Fund's resources. They apply to all members at all times. No country can alter its exchange rate by more than

10 per cent or introduce exchange control over the proceeds of trade without permission of the Fund. This will give the Fund an operating position that carries far beyond that of the B. I. S. Countries must consult it in these matters and while it is passing upon their requests in this sphere it can advise them with considerable force on their entire international policy.

Fund's exchange policy, however, may intensify the gold flow

This power in the exchange field should contribute to the orderly development of international commercial relations and help to avoid many of the disturbances to international trade and investment that shifting exchange rates and direct controls created in the 1930's. Particularly will that be true if other forms of trade control and discrimination can be held in check by broad commercial policy agreements such as are now being fostered by the State Department. Nevertheless, it must be recognized that the strong presumption in the plans against exchange rate shifts and exchange control may actually make it more difficult to achieve international balance. If Fund permission to act in the exchange field is refused -- and it will be hard to get a majority of the members to approve lowering of a competitor's exchange rate or the introduction of exchange control by a customer -- then the only recourse left may be for a country to permit its unbalanced position to continue. It will be driven to use its gold and its right to draw upon the Fund to meet the continuing deficit in its international transactions. The moral authority of the Fund may prove quite futile under these circumstances.

A suggestion as to possible action by the Board

Yet with all its weaknesses the Fund remains a definite advance over the B. I. S. both in powers and in its prospective general influence. It is part of the machinery needed for the post-war period. Its shortcomings, when measured against the problem of international balance, do not mean that it should be rejected. Rather they suggest three things: 1) that as much pressure as possible should be lifted from the Fund by securing the adoption of other international measures on a really adequate scale -- measures such as relief, international investment and liberal commercial policies; 2) that in agreeing to support the plan the Board should obtain the Treasury's agreement to work for enabling legislation under which the Board will share in the selection and control of the United States representative on the Fund; and 3) that the Federal Reserve System should prepare now to request from Congress the powers necessary to offset a very large inflow of foreign gold both from independent reserves abroad and from the resources that we ourselves will contribute to the Fund.