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June 27, 1944

Keehn W. Berry
President

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

Gentlemen:

I have your letter of June 8th, enclosing the memoranda on the plan for the International Monetary Fund and the International Bank for Reconstruction and Development. I have been slow in replying because I find it very difficult to reduce to writing my own reaction to the proposals.

In the first place I find it difficult to determine from the Joint Statement by Experts what is expected of the Fund because of the general character of the language used in the statement. The language is capable of being interpreted to provide a fund administered by an international committee for use in tiding members over temporary periods of stress in their settlements for current transactions in international trade and to provide an international committee which would study the factors affecting the position of any country having difficulty in making its settlements with a view to suggesting action by that country tending to remove the causes of such periods of stress. A Fund for such a purpose would recognize that the problem of currency stabilization is a matter of each country straightening out its own situation by internal reforms. The international committee of management, under such a conception, would serve an advisory purpose, which would be highly desirable, and the need for funds would be much less than if a broader interpretation is to be given to the general language of the Plan. There are

parts of the Joint Statement by Experts which seem to indicate that the Experts intend a much broader use of the machinery which they are providing under the plan than I have just indicated.

It seems to me that perhaps one way of arriving at what the general terminology of the Joint Statement by Experts may be construed to mean is to look to the interpretation of it by Lord Keynes in his statement before the House of Lords on May 23, 1944. For instance, the Experts state that one purpose of the Fund shall be "To promote exchange stability, to maintain orderly exchange arrangements among member countries and to avoid competitive exchange depreciation". It is difficult to see how this is possible if the provisions of Article IV are to be construed as Lord Keynes construed them in his speech of May 23rd. I have in mind particularly the part dealing with the duty of the Fund to agree to a change in value of a member's currency and the right of each country to control its internal situation without regard to its effect upon the situation with which the Fund deals. The following excerpts from that speech outline the position of Lord Keynes which I have in mind:

"Therefore, for these manifold and substantial benefits I commend the monetary proposals to your Lordships. Nevertheless, before you will give them your confidence, you will wish to consider whether, in return, we are surrendering anything which is vital for the ordering of our domestic affairs in the manner we intend for the future. My Lords, the experience of the years before the war has led most of us, though some of us late in the day, to certain firm conclusions. Three, in particular, are highly relevant to this

discussion. We are determined that, in future, the external value of sterling shall conform to its internal value as set by our own domestic policies, and not the other way round. 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. *****

"On the other hand, in this country we have already de-throned gold as the fixed standard of value. The plan not merely confirms the de-thronement but approves it by expressly providing that it is the duty of the Fund to alter the gold value of any currency if it is shown that this will be serviceable to equilibrium.

"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. That is why I say that these proposals are the exact opposite of the gold standard. They lay down by international agreement the essence of the new doctrine, far removed from the old orthodoxy. If they do so in terms as inoffensive as possible to the former faith, need we complain?"

If the language is capable of this interpretation, it seems to me the text should be modified to show that it is not contemplated that we will finance the international trade requirements of any member while it proceeds to handle its affairs in such manner as will result in a continued demand upon the

Fund or the clearing of its situation by a depreciation or devaluation of its own currency.

As I understand the statement, the Fund will operate through the central banks. It contemplates a free exchange market outside the Fund. I do not understand how Article V will operate under such conditions. The flow of capital funds will affect the exchange market and through it the operation of this Fund. As a practical matter it will be very difficult to ferret out the capital transactions and maintain an exchange market closely resembling a free market in exchange. All exchange transactions, it seems to me, with a free market would be merged and the Fund would find itself dealing with the overall situation.

Article VI has a very direct bearing on the position which we will probably occupy. The language of the section would imply that the member country which has need for scarce currency would be the one which submitted to some penalty to overcome that shortage. As a practical matter it seems that the most likely scarce currency will be the dollar and to ration it among member countries and have each member country allocate it among its nationals (and in this "the member country shall have complete jurisdiction") would mean that others will determine what we export, where our exports should go, and to what extent we should be permitted to export. The threat of application of this restriction

should be enough in itself to adversely affect the maintenance of a free market in exchange. To declare any currency scarce would have the effect of freezing any outstanding balances due in weaker currencies. This Article provides a strange shift of responsibility for an awkward situation from the debtor country to the creditor country. Lord Keynes states it as follows:

"There is another advantage to which I would draw your Lordships' special attention. A proper share of responsibility for maintaining equilibrium in the balance of international payments is squarely placed on the creditor countries. This is one of the major improvements in the new plan. 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 inter-war 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. Under Clause VI of the plan a country engages itself, in effect, to prevent such a situation from arising again, by promising, should it fail, to release other countries from any obligation to take its exports, or, if taken, to pay for them. I cannot imagine that this sanction would ever be allowed to come into effect. If by no other means, than by lending, the creditor country will always have to find a way to square the account on imperative grounds of its own self-interest. For it will no longer be entitled to square the account by squeezing gold out of the rest of us. Here we have a voluntary undertaking, genuinely offered in the spirit both of a good neighbor and, I should add, of enlightened self-interest, not to allow a repetition of a chain of events which between the wars did more than any other single factor to destroy the world's economic balance and to prepare a seed-bed for foul growths. This is a tremendous extension of international cooperation to good ends. I pray your Lordships to pay heed to its importance."

The limitations on the use of the Fund provided in Article III seem generous in view of the fact that those most likely to use the Fund are those making the smallest contributions in real assets. It is surprising, in view of the liberality of those limitations that the restrictions should, in effect, be removed by vesting in the Managers of the Fund the discretion to

waive all of the conditions. The net result would be that the weak countries can finance their requirements in connection with foreign trade through the Fund until it is exhausted without making any move on their own part toward putting their own house in order to stabilize their own currency. If this country is to make outright gifts of this sort, it seems to me that they should be made as gifts and that the American people are entitled to know just what is being done rather than have the thing done under a complicated plan which produces the effect of a gift but confuses the real nature of the transaction. It seems to me that this plan will have the effect of our underwriting the obligations of the weaker countries in connection with foreign trade or that it will involve a complete regimentation and regulation of all international transactions which would carry with it corresponding internal regimentation and regulation.

I am hesitant in submitting these comments on the work of those who are admittedly experts. I have expressed my personal opinion in response to a request and in the hope that there may be something in what I have said which may be of service.

Yours very truly,

(Signed) K. W. Berry

P r e s i d e n t.