BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 27, 1944

To Chairman Eccles

Subject: New York Times editorial

From Mr. Goldenweiser

The New York Times editorial for July 24 made four points against the Monetary Fund. Point one is stated as follows:

"One of the six declared purposes of the Fund is 'to promote exchange stability.' But again and again provisions are included to promote instability. The Fund is not allowed to raise any objection if a nation devalues its currency by 10 per cent. It must give an answer within three days if the nation wants to devalue a further 10 per cent. It must concur in practically any proposed devaluation if the change is necessary 'to correct a fundamental disequilibrium.'"

I believe that that point is answered in my memorandum on Purposes, Methods, and Consequences of the Fund, of which a copy is attached. The particular section that answers it is as follows:

"It may be contended that these provisions go a long way toward diminishing the hoped for stability of exchanges. Careful consideration, however, would indicate that the opposite is the case. Stability does not mean rigidity, and rigidity in the past has resulted in extreme instability. A country which finds that its domestic economy is suffering greatly from inability to sell abroad, because of an inappropriate rate of exchange and also finds it impossible to make other adjustments to correct the situation, has no alternative but to change the rate. If it does not change it soon enough but persists in maintaining it after it has become untenable, there are likely to be serious consequences both at home and abroad. Ultimately the rate will be changed and probably by a larger amount than would have been necessary if the country had acted promptly. Illustrations of such cases are too common to need mention.

"Therefore, the provision for orderly changes in consultation with an International Fund and with its concurrence, so long as they are in accordance with the general objectives of the Fund, is a contribution to stability rather than an impingement upon it."

The second point is:

"It is not allowed to object to a proposed devaluation 'because of the domestic, social or political policies of the member proposing' the devaluation. In other words, the Fund cannot criticize internal policies even if they are the direct cause of the devaluation. And the final agreement retains the provisions to authorize a world-wide inflation."

This point also, I believe, is answered in general terms in my memorandum in the following words:

"In order to protect the economies of the country from any untoward influences resulting from excessive rigidity of the rate, there is an explicit provision that the Fund shall not reject a requested change that is necessary to restore equilibrium, on the ground that it does not approve of the domestic social or political policies of the member country proposing the change. These provisions are not a substantive limitation on what the Fund is expected to do, but a reassurance to the countries that these vital matters were kept in mind by the framers of the proposal, and that the member countries' autonomy in domestic affairs is not threatened."

The third point is:

"Another declared purpose of the Fund is 'the elimination of foreign exchange restrictions.' But the detailed proposal itself not only permits but encourages and necessitates foreign exchange restrictions. "The post-war transitional period' is made an exception, during which nations may introduce or continue whatever foreign exchange restrictions they want. The 'post-war transitional period' is not precisely defined, but is apparently to last at least three to five years. Even after this any nation may 'regulate international capital movements,' and in some cases will be even requested to do so."

The fact of the matter is that certain allowances for exchange restrictions during the transition period are permitted and that is as it should be. It would be impossible, as I believe you have often stated, to remove all restrictions at once. What the Fund provides is that no new restrictions shall be imposed and that such restrictions as are in existence shall be removed as soon as possible. This seems rational. It does not apply to control of capital movements, which under the plan, is and as a matter of fact should be, always subject to regulation.

The fourth point is as follows:

"If a currency becomes 'scarce,' other nations may ration that currency and 'impose limitations on the freedom of exchange operations in the scarce currency.' All this implies a return to the foreign exchange restrictions developed in the Thirties. It implies a world in which individuals will act under more, not less, Government coercion and will have less freedom to buy and sell and make payments where they like."

This matter of scarce currencies is, as you also know, perhaps the most difficult one in the whole situation. It is, however, something that would have to come up whether there was a Fund or not. If America continues to sell more than she buys she will have to lend a great deal and also draw on the reserves of other countries. When that comes to an end dollars will be scarce. This would occur with or without the Fund and will not occur as soon with the Fund as without the Fund. What the Fund provides is a mechanism by which that situation can be handled in a systematic manner, namely, by rationing the scarce currency rather than leaving it to be dealt with on the principle "first come; first served," and by permitting countries to restrict dealings in that exchange, which also is inevitable. The criticism of that feature is a criticism of the general anomaly arising from the fact that the United States is a creditor nation and yet generally has an export balance. The Fund does nothing to make this situation worse, but on the contrary alleviates it and provides a way of handling it.

In regard to the last part of that point, I quote from my reply to Senator Taft's criticisms:

> ".... Far from being a step in the direction of more controls, the Fund will endeavor and make it possible to have less. If the world returned to a system of chaotic competitive changes by all countries, it is probable that exchange controls and various restrictions in this country would be inevitable. By stabilizing and regularizing exchanges all over the world, the Fund will make a great contribution towards the reestablishment of unhampered world trade and exchange. It is one of its objectives to do away with restrictions on exchange transactions, multiple currency arrangements, and bilateral agreements. It is hoped that they would disappear all over the world. To be sure, this may take some time, but the impulse coming from the Fund would be in the direction of greater freedom from government control in international transactions, rather than in the direction of regimentation."

Attachment