

FEDERAL RESERVE BANK OF NEW YORK

December 21, 1944

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

S i r s :

Since the publication of the Final Act, and its annexed Articles of Agreement, drawn up by the United Nations Monetary and Financial Conference held at Bretton Woods last July, we have carefully reviewed our discussions of previous proposals for international currency stabilization and monetary reconstruction, and we have studied the specific proposals for an International Monetary Fund and an International Bank for Reconstruction and Development, which came out of the Bretton Woods Conference.

Enclosed is a statement concerning these latest proposals which, after consideration by the Directors' Committee on Foreign Relations (Mr. S. Sloan Colt, Chairman, Mr. Donaldson Brown, Mr. Carle C. Conway, and Mr. Beardsley Ruml, ex officio), was presented to the board of directors at its meeting today. The statement can fairly be said to represent a consensus of the present views of the directors and officers of this bank based on the information which has been available to us. We are sending it to the Board of Governors as one of the series of communications (July 15, 1943, October 7, 1943, and June 19, 1944) which we have addressed to it in response to its request of June 25, 1943.

Yours sincerely,

(signed) ALLAN SPROUL
President.

P. S. Additional copies of the statement are enclosed for the convenience of the Board.

December 21, 1944.

INTERNATIONAL CURRENCY STABILIZATION

Following the request of the Board of Governors for a statement of our views on the international monetary plans, the directors and officers of this Bank have on three previous occasions - July 15, 1943, October 7, 1943, and June 19, 1944 - sent to the Board a statement of their views. These statements set forth the reasons why, in our opinion, the problem should not be dealt with in the manner proposed in the plans which were then the subject of discussion between experts of the United Nations. They also set forth, broadly, our ideas as to a wiser procedure which would hold out more promise of genuine and durable success.

Since our last statement of views was sent to you, a formal conference of delegates of the United Nations has been held at Bretton Woods and detailed agreements on an International Monetary Fund and an International Bank for Reconstruction and Development have been drafted and submitted for the consideration of the governments concerned. These agreements have been the object of close study on our part, and we feel sure that, before the stage of legislative discussion is reached, the Board will wish to know our further views with respect to the merits of the Bretton Woods proposals.

In our statement of October 7, 1943, we listed what seemed to us important drawbacks to the plans for international currency stabilization which had been put forward for public discussion at that time. To restate these objections in the briefest fashion, we felt: (1) that the plans were far in advance of even an approach to solution of some of our domestic economic problems, without which our contribution to international stabilization would probably be a negative factor; (2) that the plans might facilitate avoidance or postponement of solution of more difficult and even more important international problems, such as agreement on international trade and investment policy, world commodity and price regulation, etc.; (3) that it was impossible to pass intelligent judgment upon monetary plans

in vacuo, and that the monetary organizations proposed would in effect be an instrumentality of world government when there was no world government; (4) that the plans confused the long run requirements of currency stabilization with the shorter run problems of the transition period; (5) that it was impracticable to attempt to fix exchange rates simultaneously for all or most countries, without the continuance of exchange control, during the immediate postwar period; (6) that the plans offered too influential a role to small and debtor countries, who should not be permitted to control such a credit organization and should not, by mere right of membership, be entitled to an automatic dollar credit line; (7) that, rather than try to impose a global solution, one should break the problem down into its parts and build on the best materials available, with particular attention to first assuring internal stability and high income and employment in the leading countries and a stable exchange rate between the key currencies, sterling and the dollar; and (8) that further exploration was needed of the domestic controls which might have to be forsworn or moderated by countries participating in the currency plans.

Alternatively we stated, in the October 1943 outline of our views, that a better procedure would be the following: (1) extension of rehabilitation and reconstruction credit; (2) continuance of exchange controls as an emergency means of assuring currency stability, while applying pressure through our extension of credits toward the gradual relaxation of such controls; (3) establishment of a working relationship with Great Britain for achieving dollar-sterling stability and internal economic stability at a high level of production; (4) arranging for the adherence of other countries to the British-American stabilization agreement, as their political and economic status permitted, and pending such adherence dealing with special situations by special stabilization loan agreements or through existing or transition credit agencies; (5) encouraging the development of the conditions and the knowledge which would favor the successful functioning of an

international stabilization fund, by establishing an international organization for the continuous consideration of the problem and the centralization of information concerning it.

Our second statement of views on this subject was prepared in June 1944 following the publication of the "Joint Statement by Experts on the Establishment of an International Monetary Fund." We considered the "Joint Statement" to be, in some ways, a marked improvement on previous plans. For example, it specifically recognized the difficulty which would arise from a confusion of long run and transition objectives, and specified that the proposed Monetary Fund was not to deal with problems of relief, reconstruction and war indebtedness. It went far toward meeting our contention that continuance of exchange controls during the transition period would be necessary and that progressive relaxation of such controls is all that can be expected. It recognized the difference between exchange rigidity and exchange stability, and the difficulty of trying to fix lasting rates for a large number of currencies, by providing for greater exchange rate variability particularly during the transition years.

While we felt that constructive steps had been taken, it nevertheless seemed clear to us that the Joint Statement did not meet the test of American self-interest and, taken as a whole, was disappointing in its approach to currency stabilization. It retained several of the drawbacks which we had found in the original plans, and in two respects seemed to us to be retrogressive: (1) in its omission of all references to corrective measures to ensure the two-sided international adjustment which would keep the prospective Fund in reasonable balance; (2) in its "scarce currencies" provisions which, by authorizing deficit countries to apply exchange discrimination against the United States whenever a shortage of dollars develops (and whatever the cause of its development), placed the onus of international adjustment upon this country alone. The implication of these two provisions was that the Monetary Fund would be an instrument, not for achieving

free and stable exchanges, but rather for enabling deficit countries to make adjustments to external influences through exchange depreciation and control rather than through the two-sided international adjustment - the use of internal and external corrective measures - which is the foundation of any workable international monetary standard.

Affirmatively, in our memorandum of June 19, 1944, we repeated most of the constructive recommendations contained in our memorandum of October 1943, and we said specifically:

"What can be done now in a wider field of currency stabilization is to set up an international consultative body, which would establish the principle of continual consultation on exchange rates and other monetary matters; which would collect and disseminate information; which, perhaps, could help to arrange credits through stabilization funds or central banks, where necessary to care for temporary disequilibria in payment balances; and which would form the basis for an international stabilization fund to be established when it has a reasonable prospect of successful operation. The real borrowing and lending problems of the transition period and the longer-run problems of currency stabilization should not and need not be mixed, and international chaos is not a danger so long as exchange controls exist."

We added the further recommendation that the Bretton Woods conference, instead of proceeding with plans for an international stabilization fund, address itself vigorously to the development of special credit facilities for the transition period.

While the Bretton Woods conference actually placed most of its emphasis on the International Monetary Fund (no longer called stabilization fund) it did work out a detailed plan for an International Bank for Reconstruction and Development which we think has prospective value. This new bank - with some modifications discussed later - and the United Nations Relief and Rehabilitation Administration, could, if well managed and adequately supported by the nations concerned, provide a satisfactory solution of many, though not all, of the financial problems of the transition years. Such further need as there might be for special financial facilities to help restart world trade, could probably be found,

so far as this country is concerned, through such means as expansion of the Export-Import Bank.

On the purely monetary side, the results of the Bretton Woods conference are much less acceptable. The conference, restricted by its terms of reference, could do little more than elaborate the provisions of the Joint Statement. Moreover, the few new provisions which were introduced into the monetary plan at Bretton Woods give no cause for reassurance to those who, like ourselves, have found the plan defective in important respects. On the contrary they seem to represent an attempt to patch a mechanism the design of which does not fit the facts of world monetary operations. One of the major defects of the global fund approach is that it is based on a theoretical equality of all of the world's currencies which simply does not exist. The fact is that the fund will tend increasingly to be long of the weaker currencies and short of the key currencies (at least the dollar) in which practically all international transactions are actually carried out.

The evidence of the increasing realization of this defect in the global approach is to be seen in certain amendments and amplifications of the Fund provisions, which were adopted at Bretton Woods, especially in the expanded recapture clauses, designed to ensure the return to the Fund of larger amounts of the currencies which will be most in demand (at any rate, the dollar) in order that they may not become too scarce too soon. This dilemma of the Fund is one of the principal reasons why we have recommended that the first step in world currency stabilization should be a working agreement between the United States and Great Britain with respect to dollar-sterling stability and coordination of economic policies. With such an agreement as a starting point, it would be possible to work out arrangements between the key currency countries, on the one hand, and the countries of lesser currency weight on the other, whereby the key currencies would be made available under suitable conditions.

In the Bretton Woods Fund Agreement there have also been incorporated certain new or amended provisions (service charges and a graduated interest charge on average borrowings, etc.) which are intended to discourage excessive and continuous borrowing and thus help to maintain the Fund's liquidity and equilibrium. The extent of the Fund's control over its loan operations, however, remains in serious doubt. This is not a question of whether the Fund's lending should or should not be called "automatic"; there can be no question that all the forces of inertia, in the case of the Fund, weigh heavily in favor of the borrower. Indeed one of the arguments advanced for the Fund is that it provides its members with additional international reserves which can be freely relied upon to support domestic and international measures looking toward an expansion of world trade. Yet the likelihood of a large demand concentrated upon a few currencies (chiefly the dollar) during the transition period makes control of lending a prime necessity. It may become appropriate, at a later date, and in a situation where balances of payments fluctuate freely, and are subject only to the indirect and slow influence of monetary and fiscal policies to have automatic or largely uncontrolled lending by an international stabilization fund. Under exchange control (which the Fund now realizes must be widely maintained in the transition period), however, borrowing is a deliberate act; the authorities decide whether or not to license imports in excess of exchange receipts, and thus determine directly the character of the balance of payments. This type of borrowing should be matched with equally deliberate lending. The devices incorporated in the Bretton Woods agreement to control borrowing can hardly be effective; the burden of proof is still on the Fund to show that a member is not entitled to borrow within the limits of its quota.

The underlying assumption of the proposed Fund is that there will be a general need for foreign exchange resources on the part of members, but that these resources will be demanded from the Fund only for specific purposes other than relief, reconstruction and war debt liquidation. In reality, the situation will be

just the opposite. Only specific countries will actually need to borrow (in view of the large gold and dollar holdings which many have accumulated), while whatever is borrowed - in the absence of strict exchange control - will be of a general nature, representing the residual deficit in the borrower's balance of payments. Even with strict exchange control it would be impossible to tell conclusively that a stabilization loan is not being used for the declared illicit purposes. The simple declaration that "the Fund is not intended to provide facilities for relief and reconstruction..." cannot be effective. To avoid all possibility of indirect use of the Fund for such purposes the Fund would have to bar reconstructing countries from obtaining any aid, and it seems safe to assume that the war damaged countries did not sign the Bretton Woods Agreement with any such understanding. The moderate use of the Fund's resources for reconstruction might not necessarily be an evil. The soundness of the Fund's loans would depend, not upon the purpose for which they are employed, but upon their magnitude and upon the general balance of payments position of the borrowing country. The trouble is that, in the transition period the assumption of normal swings in the balance of payments - upon which the Fund is based - will not hold good. For many countries several years and a good deal of belt tightening will be necessary before they can get back to equilibrium.

This is the period in which, from the beginning, we have recognized that exchange stability would have to be maintained largely through exchange controls. But careful study of the Bretton Woods Fund plan suggests that certain of its features, far from leading to the gradual relaxation of exchange control as the plan is supposed to do, actually would encourage or necessitate continued exchange control on the part of members beyond this period and into the indefinite future. The recapture provisions of the proposed Fund, to be fully effective, would seem to require the use of permanent exchange control by all members; indeed, the question might well arise whether the Fund would not have to control or audit the national exchange controls. And the "scarce currency" provisions envisage the

invocation of discriminatory exchange control against a country whose currency becomes "scarce", in circumstances which are peculiarly applicable to the United States.

Finally a serious drawback of the Bretton Woods Fund plan seems to us to be the wide difference in the way its objectives and operations are interpreted abroad and here. There is no agreement as to what the plan really represents and how it will be made to function. Lord Keynes has said that

"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."*

Others, both here and in England, are just as certain that the proposals are merely a modernized version of the gold standard. While on this side of the Atlantic there has been a general tendency to view the Monetary Fund as a currency stabilization device (although some official quarters have privately said that it is primarily a credit granting mechanism), in England the Keynesian view seems to predominate, namely, that exchange rate alterations, and not two-way internal and external adjustments, are to be the usual practice. With national attitudes so far apart, it would be unwise to adopt a plan of this sort in the vague hope that viewpoints will later be reconciled.

We are, therefore, of the considered opinion that the plans for an International Monetary Fund, which have culminated in the Bretton Woods Agreement are not only based on mistaken principles but risk eventual failure which would bring further discredit upon the cause of internationalism. Fortunately, in the light of the world wide effort which brought forth the Bretton Woods proposals, the proposed International Bank for Reconstruction and Development is not subject

* Speech by Lord Keynes in the House of Lords, May 23, 1944.

to the same defects. We believe that this project has possibilities of usefulness which warrant our adherence to it, with amendments which would empower the Bank to carry on currency stabilization operations - when the time is ripe - and meanwhile to serve as a center of consultation and cooperation in currency and exchange rate matters.

The advantages of using the Bank for this purpose during the transition period, as well as for reconstruction and development loans, seem to us obvious. The Bank would be what it purports to be, a lending institution. It could obtain and provide the currencies which were actually needed for stabilization purposes, instead of trying to make a conglomerate of currencies, mostly weak ones, serve a host of demands for one or two key currencies. It could extend credit for stabilization purposes on a selective basis, after careful investigation of the merits of each case, instead of indiscriminately and semi-automatically as the Fund would. It would have other and urgent immediate jobs to do, and its organization would not require an attempt to formulate and adopt international monetary principles in circumstances which require a maximum of uncertainty in commitment and a maximum reservation of national freedoms. It could readily serve as a consultative and cooperative body on exchange rates and other international monetary matters, and as a collector and disseminator of data. Out of its experience there could develop an international stabilization fund which would really operate as a clearing mechanism, and in a more orderly world would have a reasonable prospect of success.

It has been argued that in the absence of virtually assured loans, as under the proposed Fund, countries not in immediate need of assistance might well refuse to adhere to the proposed Bank agreement in order to avoid the guarantee risk and to escape the policy obligations which are contemplated. It seems to us that international cooperation in this sphere can only be effective if there is a real desire for it and a will to make it work; that it cannot be purchased. If

various countries must be bribed to enter into a world financial organization, it is out of harmony with the real forces at work in the world and should be abandoned.

There is one major recommendation, which we have made in our previous statements, which has not been discussed here. We still believe that a specific first step toward international currency stabilization, as such, would be for this country to attempt to establish a direct working agreement with Great Britain, looking toward achieving and maintaining stability of the dollar-sterling rate. The United States and Great Britain should jointly re-examine their international financial situation with a view to setting the stage for the stabilization of the dollar-sterling rate as the necessary nucleus of international currency stabilization; and they should explore the possibility of parallel programs of internal economic stability at a high level of production. Admittedly, one of the chief uncertainties of the transition period as well as the more distant future, is the maintenance of high production and employment in the principal countries. Obviously, these uncertainties have played a major role in shaping the British attitude toward agreement with us. But our own domestic program presents no less uncertainty for us than for them. If, in addition to finding solutions for some of the abnormal international problems of the immediate postwar years, we could have a demonstration in both countries of their ability to achieve and maintain economic stability at a high level of national income, it would be a major if not a decisive contribution to genuine currency stabilization.

Finally, it cannot be reiterated too frequently, as was recognized in a resolution adopted at the Bretton Woods Conference, that no international monetary mechanism will be able to function properly and for long if world trade in goods and services is distorted and reduced by artificial barriers and hampering restrictions; nor, it might be added, if overhanging debts of past and present wars find no means of definite settlement. Further and prompt progress in the reduction of obstacles to expanding international trade is essential to the success of any and all international financial devices.