

Date December 11, 1946.

To Mr. Morrill

From Mr. Knapp

MESSAGE:

The attached paper is for discussion at a meeting on Friday morning in your office. Copies are being circulated to Messrs. Vest, Thomas, Musgrave, and Dembitz. I will telephone you with regard to the exact time of the meeting.

Attachment

December 11, 1946.

Subject: Payment of U. S. Subscription
to International Monetary Fund.

Recent action by the Treasury in meeting calls on the U.S. subscription to the International Bank indicates that an important policy question may be involved in the method used by the Treasury to pay the U.S. subscription to the International Fund due on March 1, 1947. It is the purpose of this memorandum to describe this policy matter and to raise the question of whether the Board may have an interest in how it is handled.

The U.S. subscription to the International Fund (aside from certain small amounts advanced to help cover the Fund's operating expenses) will become payable, according to present plans, when the Fund formally commences exchange operations on March 1, 1947. This subscription, totaling 2750 million dollars, is payable 25 per cent in gold and 75 per cent in dollars. Under the Articles of Agreement of the Fund, the U.S. would be entitled to tender non-interest bearing demand notes of the Treasury "in place of" such part of the U.S. dollar subscription as the Fund decided it did not need for current operations. However, under the Bretton Woods Agreements Act, the Secretary of the Treasury may tender such demand notes only "after paying the subscription of the United States to the Fund", and "in exchange for dollars to the extent permitted by the Articles of Agreement". Furthermore, the Bretton Woods Agreements Act provides that "the Secretary of the Treasury is directed to use 1800 million dollars of U.S. Stabilization Fund gold to pay part of the subscription of the U.S. to the International Monetary Fund; and any repayment thereof shall be covered into the Treasury as a miscellaneous receipt".

I would have expected, therefore, that the transactions between the United States and the Fund in connection with the payment of the U.S. subscription would have been as follows:

The U.S. gold subscription (25 per cent of the total, or 687.5 million dollars) would be paid out of the U.S. Stabilization Fund gold;

The U.S. dollar subscription (75 per cent of the total, or 2062.5 million dollars) would be paid by (a) dollars derived from monetization of the remaining 1112.5 million dollars of U.S. Stabilization Fund gold allocated by law to the payment of the U.S. subscription, and (b) 950 million dollars derived by the Treasury from other sources. Of the total dollar subscription of 2062.5 million dollars, the Fund would retain a reasonable working balance of, say, 200 million

dollars, and the rest would be turned back to the U.S. Treasury in exchange for non-interest bearing demand notes. Under the Bretton Woods Agreements Act the amounts thus returned would be available to meet general Treasury expenditures.

However, on November 25, 5 per cent of the U.S. subscription to the International Bank (\$158,750,000) became due and payable and the Treasury made the payment by tendering demand notes in the required amount without having previously paid in dollar funds.^{1/} The stipulations in the Articles of Agreement of the Bank and in the Bretton Woods Agreements Act covering the use of demand notes to meet subscriptions are exactly the same as those quoted above in connection with the Fund. While the Treasury action in meeting the payment due on November 25 was fully consistent with the Articles of Agreement of the Bank, I fail to see how it could be justified under the Bretton Woods Agreements Act.

In the case of the Bank, this issue has no great significance, but in the case of the March 1 payment on the Fund subscription, the manner of payment becomes highly important. If the Treasury does not follow the course outlined above but instead pays most of the U.S. dollar subscription directly in demand notes, the monetization of the 1112.5 million of U.S. Stabilization Fund gold, instead of taking place immediately, might be considerably delayed. In the extreme case, the Treasury might use the 950 million dollars of borrowed funds to meet the initial cash dollar contribution and calls on demand notes which are expected during 1947 and at least part of 1948; in such case the gold would become monetized only gradually during 1948 and later years.

The question which I would like to raise for discussion is whether it is felt that the Board has an interest in the timing of this monetization which would justify the Chairman's raising the subject in the National Advisory Council. Such interest, if any, would presumably arise primarily out of the fact that this monetization, whenever it takes place, will tend to cause a corresponding increase in member bank reserves. Immediate monetization would be reflected in an early increase of member bank reserves by more than a billion dollars, but this element of Treasury influence on the money market would thereafter disappear. Delayed monetization would avoid the immediate impact, but would leave in the Treasury's hands an instrument of money market control which would be particularly flexible in view of the fact that the initial cash contribution and the early calls on demand notes can be met either with borrowed funds or with the proceeds from gold monetization.

^{1/} Earlier payments on the U.S. subscription to the Bank were made initially in dollar funds, most of which have since been returned to the Treasury by the Bank in exchange for demand notes.