December 17, 1945.

Mr. Ralph E. Flanders, President,
Federal Reserve Bank of Boston,
Boston 6, Massachusetts.

Dear Mr. Flanders:

In accordance with my letter to you dated December 6, I am enclosing a memorandum summarizing the economic and financial agreements reached in the recent negotiations between the Governments of the United States and the United Kingdom. This memorandum, prepared by the technical people who assisted me in these negotiations, may be helpful to you in assessing the outcome.

I am also enclosing a copy of the statement which I issued to the press at the conclusion of the negotiations and a copy of a statement made on the same occasion by Assistant Secretary William Clayton.

Very truly yours,

M. S. Eccles,
Chairman.

Enclosures 3.

Identical letter to the Presidents of all Federal Reserve Banks.
JBK:mla

Summary of Economic and Financial Agreements Recently Negotiated Between the Governments of the United States and the United Kingdom

On December 6, the Secretary of State announced the outcome of the Anglo-American economic and financial negotiations which had been conducted in Washington during the previous three months. The principal negotiators on the U. S. side were the Secretaries of State, Treasury, and Commerce, the Chairman of the Board of Governors of the Federal Reserve System, and--in the period prior to his resignation--the Foreign Economic Administrator. The following memorandum summarizes the results achieved from the point of view of the United States.

The broad objectives of the U.S. group were: (a) to effect a final settlement of wartime lend lease to the United Kingdom and of reciprocal aid from that country; (b) to secure Britain's cooperation in the U.S. program for an expanding world economy as laid down in the Bretton Woods Agreements and in the U.S. proposals for an International Trade Organization; and (c) to provide the financial assistance required by the United Kingdom to regain her feet and participate effectively in the development of multilateral world trade.

All of these objectives were mutually interdependent. The United Kingdom could not be expected to enter into a partnership with the United States in developing a free and multilateral world trading system if it was burdened with an onerous lend lease settlement and if it failed to obtain fresh resources to tide it over the difficult postwar transition. On the other hand, the United States could not contemplate a generous lend lease settlement and the granting of fresh assistance unless Britain would commit herself to use the freedom of action which she would thereby gain in the direction desired by this country.

The background of the negotiations was dominated by the distressed international economic position in which the war has left the United Kingdom, a country whose very subsistence is dependent upon foreign trade. Although she has sacrificed for war purposes substantial amounts of her gold and readily disposable overseas assets, Britain must now reckon upon a large deficit in her current balance of payments during the postwar transition years. The volume of her imports in these years can scarcely fall below the prewar level in view of the increase in her population and of her large restocking and reconstruction needs, and she must make large overseas military expenditures in winding up the war. At the same time her exports are currently at a very low ebb due to the concentration of her productive resources during recent years upon the prosecution of the war, and she has lost the overseas income formerly derived from investments which she has liquidated to help pay for the war. In addition, she has incurred huge short-term debts to Empire and other overseas countries, the repayment of which will involve heavy sacrifices over a long period of years.

There is a widespread and sincerely held belief in the United Kingdom that, as evidenced by these circumstances, Britain assumed a disproportionate share of the material sacrifices in the war alliance, and that her more fortunately situated Allies have a moral obligation to redress the balance in some way. Such beliefs have found expression in proposals that the United States should now make a large-scale grant or at least an interest-free loan to the United Kingdom. These proposals and their justification have never been accepted, however, on the U.S. side. While recognizing that it is equitable as well as expedient to write off the bulk of our lend lease assistance as a contribution to the common war effort, we have felt that any further aid to Britain would have to be justified on its merits as an investment in future prosperity and peace.

The argument for the new credit to Britain therefore rests upon its contribution to the restoration of a workable world economy. The British Government is well aware that in the long run Britain's self-interest lies in the direction of our own aspirations. We must face the fact, however, that without assistance from us Britain would be driven by the instinct of self-preservation to virtual economic warfare in world markets. The circumstances described above make it clear that she must live on credit during the next few years. By maintaining the wartime instruments of discriminatory exchange and import control and by exploiting her bargaining position as a great market for foreign goods, Britain could hope to extract these credits from her trading partners in the Empire and other areas of the world. Certainly she would have to attempt this solution if no other path lay open. But this course would have disastrous consequences for the hopes which the United States entertains for reviving a multilateral world trading system based on freely convertible currencies. A large part of the trading world would tend to harden into an economic bloc led by Britain, which could only engender counter-blocs leading to major international frictions. International monetary and commercial conventions could scarcely survive in such an atmosphere, and the wholesome economic base which this country is striving to lay for the United Nations Organization would inevitably dissolve.

Lend Lease Settlement

The lend lease program from its inception has represented a more enlightened approach to the financing of a common war than prevailed a generation ago. The folly of burdening international relations with a deadweight of war debts was conclusively demonstrated by experience after the last World War. This time lend lease and reciprocal aid have been recognized as instruments for the pooling of resources in a common effort, with all parties finding their main reward in the winning of the war. Hence in the final liquidation of lend lease and reciprocal aid there has been no inclination by the United States to seek material compensation for goods consumed or destroyed in the war effort. It has been decided, however, to ask an accounting and settlement for lend lease supplies intended for civilian use which remained in the hands of our Allies at the end of the war, and to reserve the right of recapture by the U.S. of any lend lease articles remaining in the hands of the armed forces of our Allies.

In practice, in view of the present superfluity of our own stocks of military supplies, the right of recapture is not expected to be exercised to any significant degree, but we have demanded from the United Kingdom settlement for the "civilian inventory" of lend lease goods in British hands at the end of the war. The sum of 650 million dollars, representing the final settlement of lend lease accounts, consists mainly of this item increased by various other U.S. claims of a lend lease character or otherwise arising out of the war, and reduced by various British claims of the same sort. Furthermore, in the interests of "cleaning the slate", the final settlement includes compensation to the United States for surplus property left in the United Kingdom by our armed forces. The lump sum payment, constituting final settlement of the financial claims of each Government against the other arising out of the conduct of the war, is to be financed on the same terms as the new money credit (see below).

The United States is also entitled to regard as a lend lease "benefit" the commitments accepted by the United Kingdom in the field of international exchange and commercial policy, which are described in the following section. Article VII of the Master Lend Lease Agreement signed by the United States and the United Kingdom on February 23, 1942 provided that such benefits should include provision for "agreed action by the United States and the United Kingdom, open to participation by all other countries of like mind" directed to the expansion of world trade, the reduction of trade barriers, and the elimination of discrimination in international commerce.

Agreements on International Exchange and Commercial Policy

In the course of the recent negotiations, the British committed themselves to ratify the Bretton Woods Agreements and to accept the U.S. proposals for an International Trade Organization as a basis for discussion at a general International Conference on Trade and Employment to be held next year. In addition to these general commitments, the British have accepted in the financial agreement certain specific obligations anticipating or going beyond those contained in the Bretton Woods Agreements and the International Trade Organization proposals.

British adherence to the Bretton Woods Agreements is not specifically covered by any of the documents emerging from the negotiations, but the British Parliament has been asked to ratify these Agreements concurrently with its action on the U.S. credit. It became clearly understood during the negotiations not only that Britain would join Bretton Woods if the new money credit were approved, but also that it would not join Betton Woods if the proposals for a credit failed.

The general U.S. proposals on international trade and employment with which the United Kingdom has expressed full agreement on all important points, are far too broad in scope to be summarized here. They embrace the fields of trade barriers and discriminations, problems relating to commodities in world surplus, cartels, state trading, etc. They involve a broad program of reciprocal reduction of barriers to world trade and the establishment of "rules of the game" for international trade corresponding to and supplementing the international exchange code contained in the Bretton Woods Agreements. These rules would be administered by an International Trade Organization which would collaborate with the Bretton Woods Institutions in developing an expanding system of world trade on a multilateral, non-discriminatory basis. On the particularly vexed point of British Empire preferences, the United Kingdom expressed agreement with language in the U.S. proposals looking to the eventual abolition of preferences, but retained the right, with some limitations, to bargain for tariff reductions on British exports in exchange for the removal of Empire preferences in the British market.

As mentioned previously, certain sections in the financial agreement (sections 7, 8, 9, and 10) contain specific commitments with respect to the United Kingdom's exchange and import restrictions which anticipate or go beyond the Bretton Woods Agreements and International Trade Organization proposals. In general these commitments are to take effect one year after the date of the agreement (unless the time is extended by mutual agreement), and will run until the end of 1951. It is anticipated that during this period the International Monetary Fund and International Trade Organization will come into full operation--at least so far as the United States and the United Kingdom are concerned--and these institutions will continue to administer the "rules of the game" after 1951.

In the case of Britain's exchange restrictions vis-a-vis sterling area countries, however, and in the case of the treatment of sterling balances accumulated by foreign countries during the war, there is no time limit to the commitments. The United Kingdom undertakes to dismantle the discriminatory system of sterling area exchange controls which was developed during the war and to make the proceeds of sterling area exports to the British market freely convertible for purchases in any country. It will also dissolve the "dollar pool" arrangements under which all dollar receipts and expenditures by sterling area countries were managed from London. Furthermore, Britain undertakes not to use the repayment of accumulated sterling balances in such a way as to discriminate in favor of British exports; any of these balances which are available for current payments will be freely convertible for purchases anywhere.

In the case of trade and exchange relations with the United States, the United Kingdom agrees to abandon all exchange restrictions immediately (i.e. as soon as the credit is made available) and, in addition, not to discriminate against U.S. exports to the British market by means of quantitative import restrictions. These commitments are subject, however, to the qualification that the United Kingdom reserves its rights under the Bretton Woods Agreements to place limitations upon imports from the United States if the dollar becomes scarce in the International Monetary Fund.

Moreover, the United Kingdom agrees to dismantle its exchange restrictions on payments and transfers for current transactions with all other non-sterling area countries, except to the extent that the continuance of such restrictions is authorized by the International Monetary Fund. Britain specifically waives, however, the special rights which she would have had under the Fund Agreement to maintain exchange controls during the postwar transitional period. In other words, Britain will abandon the restrictive bilateral exchange arrangements which she has developed over the past years with countries in Latin America, Continental Europe, and elsewhere.

All these commitments should add up to the restoration of full convertibility of the pound sterling for current transactions within one year from the date of the agreement. The U.S. negotiators felt justified in seeking this objective since with the new credit Britain should be able to afford it. The British retain the right, however, to seek an extension of time by mutual agreement in case unforeseen circumstances should arise.

Amount and Terms of the Credit

The British originally hoped to obtain a sum of 5 to 6 billion dollars, but after close examination of the relevant data concerning Britain's needs during the transition period and of the other possible sources of credit open to her (notably Canada and certain of the sterling area countries), the U.S. negotiators came to the conclusion that a smaller amount would do the job. With the amount of the lend lease-surplus property settlement fixed at 650 million dollars, attention was concentrated on the amount of the new money credit. This was finally fixed at 3,750 million dollars, making a total credit of 4.4 billion dollars. The two parts of the credit will carry the same terms but they differ in that the settlement for lend lease-surplus property is already authorized by existing legislation, whereas the new money credit will require specific authorization by Congress.

The 3,750 million dollars of new money is to be made available in the form of a line of credit on which the British may draw until the end of 1951. Payments on this credit (and on the lend lease-surplus property credit) will commence at the end of 1951, and no interest will accrue until 1951. The payments will be made in equal annual installments covering both interest and principal over a period of 50 years. Interest will be calculated at the rate of 2 per cent per annum, but the effective rate over the whole life of the credit is reduced to about 1.7 per cent as a result of the waiver of interest in the first 5 years and may be further affected by waivers in later years as described below. Assuming that all of the new money credit is in fact drawn, these terms call for annual installments of about 140 million dollars per annum, equivalent to less than 2 per cent of Britain's anticipated annual overseas payments.

While the U.S. negotiators insisted on the adoption of a basic interest rate high enough to cover the average cost of money to the U. S. Treasury, they were willing to provide for the waiver of interest in any year in which this would place an undue burden upon the United Kingdom. There was in fact, some discussion of introducing flexibility into the payments of principal, but this idea was eventually dropped.

The waiver clause in the final agreement is based on the principle that Britain should not be required to pay interest in a year in which she is unable to finance a volume of imports equal to prewar. The selection of a prewar base has unfavorable aspects from the British point of view; even to maintain prewar living standards (which she hopes to improve upon) Britain must now import more than prewar since her population has grown and since she must support a much larger export trade merely to make good her losses of overseas income and to amortize her foreign debts arising out of the war. However, the agreement stipulates that no waiver can be granted unless Britain's current income available to pay for imports, reckoned as a 5-year moving average, is insufficient to finance imports at the prewar level. Even then Britain must determine that "a waiver is necessary in view of the present and prospective conditions of international exchange and the level of her gold and foreign exchange reserves". While this determination is to be made only by the Government of the United Kingdom, the U.S. negotiators felt confident that Britain would not take such action lightly. A public appeal for a waiver of interest would be seriously damaging to British prestige and credit and it is believed that no British Government would make such a request unless the situation really demanded it.

Furthermore, if in any year the United Kingdom secures waiver of the interest portion of the installment due to the United States, it must make a proportionate reduction in that year in payments on the old sterling balances arising out of the war and cannot pay interest in that year on any of the long-term loans which British Commonwealth countries (notably Canada) may make to help Britain through the postwar transition period. Indeed in the case of these latter loans Britain has made a broader commitment, namely that she will not negotiate them on terms any more favorable to the lender than the terms of the U.S. credit.

Section 10(i) of the financial agreement contains a general exposition of British intentions with respect to the settlement of the huge sterling balances which have been accumulated by foreign countries during the war. These accumulations may amount to as much as 14 billion dollars at the end of this year, of which the bulk is held by sterling area countries (India, Egypt, and Eire are the largest individual holders). The British intend to negotiate a final settlement of these balances in the near future, involving in the case of sterling area countries a down payment in convertible currency, cancellation of part of the claim as a contribution to the cost of the war, and funding of the rest for gradual amortization after 1951. These negotiations may prove very difficult, but as noted previously the British are bound in any case to terminate the discriminatory use of these balances within one year from the date of the agreement.

The United States has a definite interest in how the British actually handle this problem, especially in so far as the solution affects the use and repayment of the U.S. credit.

In connection with the use of the U.S. credit, the British undertake to meet their presently outstanding obligations, including the old sterling balances, out of resources other than the line of credit. This provision is not very meaningful since the British can draw on the U.S. credit the full amount of their deficit on current account during the transition period and apply to the repayment of old sterling balances the proceeds of credits which they may obtain from other countries. However, the U.S. negotiators were satisfied, after the amount of the new money credit had been cut down to 3,750 million dollars, that the British would not be able to afford any excessive cash payments to the old sterling creditors.

The payments on the old balances after 1951 will, in effect, rank pari passu with service on the U.S. credit so that the United States has an interest in seeing them kept small. It is clear, however, that the interest of the United Kingdom is the same as ours and that in arranging the terms on which the old sterling balances are to be funded the British will drive as hard a bargain as they can. Furthermore, the British felt that they could not, unilaterally and without consultation with their creditors, commit themselves to the United States concerning the scale of payments which they would make on old sterling balances in future years. Hence the U.S. side agreed to accept merely the provision in the waiver clause which states that annual payments on the old sterling balances in excess of 175 million dollars (43,750,000 pounds) are not deductible in calculating the net income available to the United Kingdom for payment of imports.

Finally, attention is called to the various provisions in the financial agreement for future consultation and mutual agreement by the parties. Section 12 enables either Government to ask for reconsideration of any of the provisions of the agreement but envisages action by Congress and the British Parliament on any proposed changes. On the other hand, the consultation on particular matters which is provided for in various sections of the agreement (notably the sections on exchange and import controls) is intended to take place between the two Governments without recourse to their respective legislatures.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

For the Press

For Release at 5:30 p.m., E.S.T.,
Thursday, December 6, 1945.

December 6, 1945.

Statement by Chairman Eccles on British Loan

The choice before us is clear. We can either help Great Britain to help herself to recover from the situation in which the war has left her or we can refuse the help. It is not a question of whether we can afford to provide the help, but whether in our own long-run interest we can afford not to provide it. The decision, in my judgment, will largely determine whether we will revert to a world of economic blocs, which make for political blocs and hence for war, or whether we move forward towards the kind of economic world envisioned in the Bretton Woods Agreements, which is essential if the United Nations Organization is to succeed. If Congress approves the result of this long and difficult negotiation, we will have taken another long stride, in my opinion, towards the goal of an orderly and peaceful world.