BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON 25, D. C.

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

August 19, 1947.

SECRET AND AIRMAIL

Dear Mr. Chairman:

The first meeting with the British Delegation, headed by Sir Wilfrid Eady, was held in the Treasury yesterday. Those present on the American side were Secretary Snyder and Mr. Southard from the Treasury; Mr. Lovett, Mr. Thorp, and Mr. Ness from the Department of State; Mr. Bruce and Mr. Blau from the Department of Commerce; Mr. Martin and Mr. Gaston from the Export-Import Bank; and Governor Szymczak and myself. The meeting was devoted entirely to a statement by Sir Wilfrid Eady of the broad developments in England during 1946-47. It is understood that the British are not seeking a new loan at the present time but that they will seek relaxation of the clauses in the loan agreement relating to convertibility and non-discrimination. However, Sir Wilfrid made only passing references to these subjects and made no concrete proposals. A meeting with the British at staff level is scheduled for 10 o'clock this morning, and perhaps we shall learn at that time what the British have in mind. One reason for Sir Wilfrid's reticence may be that Cobbold, Deputy Governor of the Bank of England, who left London Sunday night to join the Delegation, after a meeting with the British Cabinet, had not arrived by the time of the meeting yesterday afternoon.

I am enclosing a note on the high spots of Sir Wilfrid's remarks. Also enclosed is a paper which has been prepared by the Staff Committee summarizing the information which has been presented by the British concerning their balance of payments and discussing the various measures which might be taken to meet the British situation. Also enclosed is a further paper on the discrimination subject which has been prepared by a subcommittee. Another paper is to follow on the subject of what concessions might be made to the British with respect to convertibility.

It is still far from clear how much the British would benefit from relaxation of convertibility and non-discrimination, but we shall ask them to demonstrate to us what they would hope to accomplish. Assuming that they convince us that such relaxation would really be helpful, the main policy questions will be as follows:

(1) With respect to discrimination, how far can the Administration go in granting concessions without the approval of Congress? As pointed out in my memorandum of August 11, it is possible to go some distance through interpretation of the existing Section 9 in the Financial Agreement, but under the terms of the Agreement any change in this Section would appear to require the consent of Congress. This is the position taken by the Treasury lawyers, but as you will see from the enclosed Staff Document No. 6, the State Department lawyers seem to feel that some latitude exists.

(2) With respect to convertibility, there are a number of technical questions as to just how far it should be relaxed, but the Administration has broad power to handle this problem without consultation with Congress.

One broad question has arisen, however, as a result of the fact that the sections on convertibility provide an exception for any exchange restrictions which are approved by the International Monetary Fund. This means that the United States, instead of granting concessions to the British under the Financial Agreement, could hold to the Agreement but invite the British to submit their case to the International Monetary Fund. We could then instruct our U.S. Executive Director to support liberal treatment of the British application. The British probably would resent having the matter handled in this way, but from our point of view there are advantages and disadvantages. The main advantages are that it would build up the authority of the Fund and, assuming that the other countries in the Fund agreed with our position on the British application, their support might strengthen our hand in defending the action taken to our Congress and public. On the other hand, it might be argued that this is a matter primarily between the United States and the United Kingdom which really ought to be solved bilaterally between them, and despite the letter of the Agreement Congress might think the Administration was being "tricky" if with one hand it stood on the letter of the Agreement but on the other hand instructed the U.S. Executive Director in the Fund to support concessions through the Fund machinery. This question has not yet received any thorough discussion even at staff level, but if you have any strong feeling on the matter, I should like to know it.

I will report to you further as the negotiations proceed.

Sincerely yours,

Burke

J. Burke Knapp,
Assistant Director,
Division of Research and Statistics.

Honorable M. S. Eccles,
c/o Hotel Ben Lomond,
Ogden, Utah.

Enclosures 3

Highlights in Statement of Sir Wilfrid Eady at Opening Meeting between National Advisory Council and British Delegation on August 18, 1947

Sir Wilfrid gave a general account of the British developments in 1946-47.

He pointed out that in 1946 the United Kingdom balance of payments was far less unfavorable than had been expected. The deficit on current account was only 1,600 million dollars, and only half of this had to be covered by drafts upon dollar resources (the United States and Canadian loans and Britain's gold and dollar holdings). The other half was financed by other countries, mainly through the accumulation of sterling balances in London. Sir Wilfrid pointed out, however, that the very rapid recovery of exports to 111 per cent of 1938 volume by the last quarter of the year was due in part to the existence of a strong sellers' market in the world; he also pointed out that imports amounting to 65-70 per cent of prewar were unduly low because of world shortages, with the result that the United Kingdom had to run down its stocks. Sir Wilfrid also stated that despite the healthy appearance of the domestic economy, certain weaknesses were developing which made themselves acutely felt in 1947. These were:

(1) Accumulated under-maintenance of capital equipment in industry and transportation;

(2) Inadequate stocks of fuel and raw materials; and

(3) General "over-loading" of the economy as a result of demands for

(a) physical reconstruction and modernization,

(b) raising the level of consumption, and

(c) expanding exports beyond all previously known levels.

Sir Wilfrid pointed out that all of these matters came to a head with the mid-winter fuel and transportation crisis. He attributed the disastrous results of this crisis largely to the fact that the British economy was operating on such narrow margins (i.e. with such inadequate stocks) with the result that the tieup in transportation in the mid-winter blizzards soon brought the whole industrial machine to a stop. In terms of exports, Sir Wilfrid estimated that this industrial stoppage had set the export program back by some 800 million dollars.

Sir Wilfrid pointed out that the convertibility of sterling and non-discrimination in British trade were fundamental bases of the original Financial Agreement and that the British had accepted them in their own self-interest. He stated, however, that a basic factor had arisen to "falsify" the expectations which both parties had had in negotiating the Financial Agreement, namely the world scarcity of dollars. Sir Wilfrid felt that this was not really an exchange problem but essentially a production problem. He said that production in the United States had so far outrun production in the rest of the world that naturally we had generated a huge export surplus which was causing great pressure on the rest of the world to make payments to the United States. This was a cause of general embarrassment to the United Kingdom, since foreign countries were driven to use the convertibility of sterling to the hilt in order to make payments to the United States. Not only were most foreign countries now unable to finance Britain by accumulating sterling balances; they were even restricting imports from the United Kingdom in order to maximize their sterling earnings, all of which were promptly converted into dollars at the expense of British dollar resources.