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Chairman Eccles

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date August 8, 1944

To Board of Governors

Subject:

From Mr. Goldenweiser

An article on the Bretton Woods agreements has just been completed and will be distributed tomorrow. The attached is a record of the principal issues that came up in Bretton Woods, which I thought were worth recording for our own use while they are still fresh in mind.

(Signed) E. A. G.

Attachments 15

STRICTLY CONFIDENTIAL July 29, 1944

## ISSUES AT BRETTON WOODS

For our records and for the use of the Board, an attempt is made below to list the principal issues that came up at Bretton Woods, as far as they came to my notice, indicating with what countries they arose and what disposition was made of them.

Throughout the discussions, particularly of the Fund, there was a continuous issue as to the extent to which the Fund should be automatic, which is what the British preferred, or constantly use its judgment and influence, as the Americans preferred. The net result is a series of compromises that appear in a number of sections, but in general it may be said that the Fund emerges from Bretton Woods with considerably more discretion and power than at one time seemed probable.

## FUND ISSUES

### 1. Quotas and Contributions

With a few exceptions, all the countries wanted to have as large a quota as possible in the Fund and as small a contribution as possible to the Bank. This is for the reason that the quota in the Fund not only determines a country's voting power but also measures the extent to which it can draw on the resources of the Fund. The issue was particularly tense with Russia which, according to any statistical measurement, was not entitled to more than perhaps 700 millions. In the end she was given 1200 millions as a part of a bargain. In return for the larger quota the Russians were supposed to give up their claims to a reduced gold contribution and other matters in which they were interested, but they continued to bargain, and as a matter of fact got an exemption, for a five-year period, of newly mined gold from the obligation to reduce the Fund's holdings of Russian currency in case her gold increased during a year.

China was very much disappointed in her quota of 550 millions, principally because the delegates had stated in China that they were going to have 600 millions. It is for this reason that China, contrary to the general trend, insisted on having 600 millions as its contribution to the Bank. This enabled them to say that that was the figure to which they had referred, and so their face was saved.

France felt very badly about receiving only 450 millions. Other countries, which I do not remember, were dissatisfied with their quotas but finally consented.

Contributions to the Bank were larger than Fund quotas in a few cases, particularly for the United States, which went up from 2,750 to 3,175 millions, and for Canada. South American countries got their contributions reduced by about 30 per cent from their quotas. The Russians insisted that they would contribute only 900 millions to the Bank, compared with a quota of 1200 millions in the Fund, but at the last moment in a dramatic gesture raised their contribution to 1200 millions in view of the fact that the British figure was the same in both cases and the American figure much larger for the Bank than for the Fund.

2. Changes in exchange rates

The next most important issue was about the extent to which exchange rates could be adjusted without approval of the Fund. This was an important issue with the United Kingdom, which was under the political necessity of protecting its autonomy. The actual outcome is not materially different from the joint statement. Countries are permitted to make a change of 10 per cent in the exchange value of their currency after consultation with the Fund, but without requiring its concurrence. They can make another change of 10 per cent, but this second step requires concurrence by the Fund which, however, must be given within 72 hours. This is to take care of urgent developments. Any other changes require concurrence of the Fund without a time limit on the reply.

The form in which the matter came up principally in Bretton Woods was that the British wanted to have the language of the agreement be such as not to make a change without the Fund's approval a violation of an obligation, but merely a disagreement with the Fund. In this respect their wishes were met. I do not believe that anything material was sacrificed in the process. The way it is stated now is that, if a change is made without the Fund's concurrence, the Fund may suspend the country making the change from further use of the Fund's resources, and later on, if it still thinks that the change is unjustified, it shall require the country in question to withdraw from the Fund. The so-called "cooling off" period between suspension and withdrawal was a new feature and not a damaging one. The net effect of an unauthorized change is still expulsion from the Fund, but the matter is stated more politely and makes it easier for many countries to secure approval of their governments.

The most extreme objection to control of exchange rates came from Australia, which wanted to have one of the purposes of the Fund be "to secure orderly changes in exchange rates." This language seemed entirely the opposite of the purposes of the Fund, which was generally understood to be the avoidance of changes and provision for orderly methods of making such changes as are inevitable. Australia kept a reservation on this point, as well as on others, and it is somewhat doubtful whether she will ultimately join the Fund. Her painful experience in deflation caused by adhering to rigid exchange rates in the early Thirties on advice of Sir Otto Niemeyer made Australia very reluctant to give up any authority over her exchange rate.

There was a good deal of discussion about the paragraphs that directed the Fund not to refuse a proposed change in a rate on account of domestic political or social policies in the applying countries. This language was retained and seems to be reasonable enough. The language which appeared at one time prohibiting the Fund from refusing an exchange change on the ground of economic policies that led to full employment was ultimately dropped.

The Russians made a considerable to do about recognition of the fact that their form of government changes their relationship to foreign trade. They insisted that it be stated specifically that exchange rates can be changed without limits if they do not affect international transactions. So far as I can figure out, there is no such possibility even in Russia, but they won their point.

3. Exchange spreads

There was considerable discussion about exchange spreads. The British wanted a wide spread between buying and selling prices. There was also a question whether the spread should be uniform for all countries or whether it should be a maximum, leaving adjustments to individual countries. Finally it was agreed that for spot transactions the spread should not exceed a maximum of one per cent, leaving it to each individual country to determine the spread within that margin. A wider margin for futures was authorized subject to approval by the Fund.

4. Use of gold to support exchange rate

An issue of some importance, principally with England, was the extent to which a country was supposed to use its reserves to maintain its exchange rate in order to fulfill its obligations under the Fund. England was inclined to argue that, when a country no longer could draw on the Fund, it was not obliged to maintain its rate. This was not acceptable to the United States. It was finally agreed that a country must use its reserves to the extent necessary to prevent its rate from falling below the prescribed parity.

5. Uniform change in price of gold

An issue arose in connection with authority of the Fund to make a uniform change in the gold value of all the currencies of member countries. The fact that gold is a good deal of a fetish was apparent in this discussion. It was agreed that no change could be made unless the three countries having 10 or more per cent of the quota agreed. Monteros, of Mexico, insisted that in addition there should be a requirement that the majority of all the countries agree. Holloway, of South Africa, proposed as a compromise that it be a third of the countries. The final outcome was that no requirement of any particular number of countries is mentioned, except for the three leading countries, but that any country would refuse to accept a change in its currency value within 72 hours. This technicality protects the sovereignty of the countries, but has been described as authority for a country to cut its own throat on 72 hours notice.

6. Premiums on gold

A minor issue arose about the desire of some South American countries, notably Colombia, to have the privilege of paying more than the stated price for gold in order to encourage gold production. We took the view that encouragement of gold production was not particularly desirable and that the price should be uniform everywhere. It was stated to the Colombian delegate, however, that there are so many ways in which a country can encourage gold production, such as tax remission, or special bonuses to the company, that it would be impossible for the Fund to do anything about it if the country wished to pursue such a policy.

7. Blocked balances

India and Egypt, as well as Australia, were anxious to have some provision by which the Fund could be used for the purpose of liquidating at least a part of their blocked sterling balances. The British were, of course, opposed to such an arrangement. In an early draft of the White plan there was some provision for taking care of a small amount of those balances and this was repeatedly quoted in the debate. At the time the plan was originally drawn up, however, the balances were only 4 billions, whereas now they are 12 billions. It also became clearer as the plan developed that it would not be fair to have it burdened with the liquidation of any part of accumulated indebtedness. It will have enough to do to take care of current fluctuations. In the end the liquidation of balances through the Fund is barred and the Fund can be used for their liquidation only in the same way as it can be used for other capital exports, which is only to a very moderate extent, and by countries that have used the Fund very little.

8. Gold payments

A political issue was involved in the demand of Russia to reduce her gold payments to the Fund by 50 per cent on account of war devastation. As a part of the bargain by which Russia was given a large quota this request was denied. To have admitted it would have necessitated granting similar exemptions to a lot of other countries with the consequence that the gold in the Fund would have declined materially.

9. Location of head offices

A political and prestige issue arose in connection with the headquarters of the Bank and the Fund. In the end they are both to be located in the country with the largest contribution, which is the United States. England, however, made a reservation on that point to have it reconsidered by the governments in connection with the establishment of other international organizations.

10. Initial location of gold

There was also some rather inconsequential discussion as to where the gold was to be held, Russia being anxious to have it recognized that at least as much gold as she contributed would be held in Moscow. This was not granted and the final solution provides that half of the gold shall be in the United States and 40 per cent in the next four principal contributing countries. However, all of this applies only to the initial location of the gold and it was made clear that its movements shall be in accordance with the Fund's business. It is, therefore, a matter of no consequence.

11. Charges

Charges for drawing on the Fund were a matter of debate, but not a sharp issue. It was agreed by all that there would be an initial service charge as well as additional charges and that they should be graduated in accordance with the amount of the draft on the Fund's resources as well as with the length of time of their use. There were arguments about the steepness of the rate and some reduction was made. The principle, however, was considered basic and was maintained.

12. Definition of current transactions

There was a rather unreasonable amount of discussion about the definition of current transactions for which the Fund's resources are to be used in the main. The main point of difference was whether immigrant remittances should be counted as current transactions. A great deal of oratory was expended on that subject. Finally, the word "immigrant" was taken out and the definition was made to include as current transactions moderate remittances for living expenses no matter by whom and to whom they were sent.

13. Management

There was considerable argument about management, the principal point of which was representation on the executive committee. Finally, it was agreed that the five principal countries must be represented and that of the remaining seven memberships two shall be given to South America. This guarantee of two members to South America raised an objection by the Egyptians who wanted at least one for the Middle East. The Middle East, however, was not recognized as a unit. There were also arguments about the relationship of the managing director to the executive director and as to the continuity and voting mechanism in the Executive Committee.

14. Reports to countries not using the Fund

An issue arose in connection with a section of the Fund agreement which provides that the Fund has authority to call attention of a member country even though it is not using the Fund to the fact that its policies are likely to result in international disequilibrium. The British objected to that because they do not like to have anyone tell them what they may or may not do. They suggested that the Fund shall have the right to communicate its views informally to any member country. This did not seem to be sufficient, because if a country was pursuing bad policies, it was very likely that sooner or later it would have to come to the Fund, and the time to warn them was beforehand. It also seemed important that countries that join the Fund should feel that they are subscribing to rules of the game and must observe them, regardless of whether or not at the moment they are drawing on the Fund's resources.

Question was raised among American members as to how Congress would like the idea of having an international fund tell this country that what it was doing was wrong. It was finally agreed that by a 2/3 majority of the total voting power the Fund could decide to publish a report made to a member country regarding its monetary or economic conditions and developments which directly tend to produce a serious disequilibrium in the international balance of payments.

The Russians insisted that there be a sentence added to the effect that the Fund shall not publish a report involving changes in the fundamental structure of the economic organization of members. This was adopted because it seemed harmless and pleased the Russians.

15. Information

The Russians made a good deal of a point of supplying only the minimum of information. There was, however, worked out a reasonably satisfactory schedule of information which each country must supply. The Russians agreed to this schedule.

16. Underdeveloped countries

India and other underdeveloped countries were anxious to have it stated that one object of the Fund is to contribute to the development of underdeveloped countries. New Zealand was interested in that too. Many forms of language were discussed and it was pointed out that the development of countries was not a purpose of the Fund, though it might be one of its ultimate consequences. In the end contribution to expansion of real income and development of the productive resources of all members was the term adopted.

## BANK ISSUES

1. Contributions

Contributions to the Bank have been discussed under No. 1 under Fund Issues.

2. Ratio of guarantees to capital

The permissible ratio of guarantees by the Bank to the Bank's capital was an important issue. The Treasury wanted to go as high as 300 per cent, the Dutch and the British wanted to go down to 75 per cent. It was finally agreed that the ratio should be 100 per cent of capital, surplus, and reserves. This made the Bank conservative as to aggregate. At the same time, the loaning provisions were liberalized so that the Bank could take substantial risks. This is probably a good solution because risk-taking is necessary if the Bank is going to be of any service, while at the same time they could not sell bonds unless there was an adequate protection to the bondholders.

3. Defaulted bonds.

Another issue in connection with the Bank was about taking up of defaulted bonds which were covered by the Bank's guarantee. Taking them up had the advantage of reducing interest payments and strengthens the Fund. At Ned Brown's insistence this was provided.

4. Tied loans

An issue on which I am not quite clear is the question of the extent to which the proceeds of loans made by the Bank must be expended in the country in which the loan is made. I believe that the final outcome in regard to direct loans out of the Bank's capital is that the loans must be expended in accordance with the consent of the countries making the loan, which means that they could require that the money be spent in their country, or they could not require this. In regard to guaranteed loans, it is provided that the proceeds must be available for spending in any country.

5. Fund and Bank membership

There was a question as to whether it was necessary to belong to the Fund in order to be able to belong to the Bank. It was decided that it was, and that a country which ceases to be a member of the Fund would have to withdraw from the Bank, unless the directors by 3/4 majority decided otherwise.

## OTHER ISSUES

There was also a third group of questions not belonging to either the Bank or the Fund which were assigned to a body called Commission 3. In that group the two principal issues were:

1. Silver

The silver people made the usual attempts at recognition of the monetary importance of silver. Monteros, of Mexico, was the leader. The only recognition silver got was acceptance of silver along with other commodities as collateral to be received by the Fund, presumably at market prices, and an indication that the role of silver should be further studied. They barely got face-saving recognition.

2. Bank for International Settlements

There was a resolution about liquidating the Bank for International Settlements, which was adopted. A proposal that the BIS conduct should be investigated was dropped and Beyen, who used to be President of the BIS, said that he regretted that no investigation would be made because he would have liked to have seen the facts brought out.