

HEARINGS ON BRETTON WOODS ENABLING LEGISLATION  
BEFORE HOUSE BANKING AND CURRENCY COMMITTEE

May 4, 1945 -- 10:30 A.M.  
(Twenty-second day of hearings)

The Committee resumed the questioning of Dr. Palyi. Representative Crawford (R. Mich.) asked about the danger of American foreign lending adding to inflationary pressures in the United States and Dr. Palyi said he thought the danger was great and that we should reduce our exports immediately after the war rather than expand them.

Rep. Sumner (R. Ill.) asked Dr. Palyi to explain more fully why he did not believe the Fund would prevent exchange restrictions and depreciations. Dr. Palyi replied that the British were clearly planning to restrict exports of capital and travel abroad although they could not officially use the Nazi variety of multiple currency practices under the Fund plan. In his opinion, however, since different kinds of pound sterling balances will be usable for different specific purposes they will certainly have different values on the black market. Rep. Sumner asked if control of capital movements was not a thoroughly totalitarian measure, to which Dr. Palyi replied that it was more precisely a question of government interference. Dr. Palyi commented in particular that the wartime blocked sterling balances never have to be unblocked and that sterling balances acquired in the future can also be blocked. In his opinion the Fund provides that debts need not be paid and he cited Article XIV as specifically mentioning that international debts arising out of the war need not be paid. Control of capital transactions and restrictions on scarce currency transactions will prevent the free flow of capital and the Fund as a whole legitimizes defaults. In reply to further questions by Rep. Sumner Dr. Palyi said he thought the dangers of depreciation under the Fund plan had been overemphasized. Dr. Palyi then said one great weakness of the Fund was that it did not distinguish between countries with temporary balance of payments deficits and countries like Britain which have to make fundamental changes to balance their transactions and need long-run credits.

Rep. Sumner asked Dr. Palyi if it was not an imposition to take American tax money and put it into a Bank run by debtors. Dr. Palyi objected that we have a veto power over the use of dollars by the Bank. Dr. Palyi went on to say the Fund was almost automatic, that it would probably be able to exert an influence in the direction of sound policies but that the actual agreement makes no reference to such action and in fact says the Fund cannot interfere with a country's internal affairs. Rep. Sumner asked if the Bank's tax exempt securities would not compete with our government loans and Dr. Palyi said the amount would be trifling and in any case "the Federal Reserve and our monetary management" could regulate the time at which the Bank issued or guaranteed securities.

Rep. Sumner suggested that the bankers support the Bank because it is a "Christmas present" to them and Dr. Palyi said there was no doubt that the Bank would provide the American banks with additional business and that the Fund would take some business away from the Bank. Dr. Palyi said the Bank could try to manage foreign countries under the present agreement and that the only purpose of the Bank should be exchange stabilization.

(Afternoon session - 2:30 P.M.)

Rep. Talle (R. Iowa) questioned Dr. Palyi on the possible inflationary pressure from foreign demands for our goods, the meaning of "fundamental disequilibrium", invasion money, the meaning of exchange restrictions and economic warfare. Dr. Palyi agreed with Rep. Talle that the Fund would not remove exchange restrictions and suggested that if a transition period is necessary it should be limited to a definite short period.

When Rep. Smith (R. Ohio) asked Dr. Palyi if the Fund and Bank would lead to inflation in this country Dr. Palyi said the amounts involved were so small that they would not make an appreciable difference but that he understood large amounts would be made available under lend-lease and other programs. Rep. Smith read several quotations from address by Lord Keynes on the extent to which sterling would be tied to gold under the Fund plan and several statements from the press release issued at Bretton Woods on the Purposes, Methods, and Consequences of the Fund contrasting exchange rigidity and exchange stability.

Rep. Kunkel (R. Pa.) suggested that Dr. Palyi had been confused and that bonds issued by the Bank are taxable. He then asked Dr. Palyi whether the British were anxious to avoid adding to their external obligations. Dr. Palyi said the British would not officially want to raise a loan abroad but agreed with Rep. Kunkel that they might make more arrangements of the sort made with Sweden.

Before Mr. de Vegh was called Chairman Spence said the Committee would conclude hearings the next week.

Mr. I. de Vegh, consulting economist of New York City, read a prepared statement. He said he believed the Fund was untimely, that at this late stage we should try to make it more workable, that it was a major strategic error to negotiate the Fund before making political and trade agreements. In his opinion we could have shown willingness to cooperate by expanding the Export-Import Bank. By negotiating the Fund we have given up our most valuable bargaining weapon. Mr. de Vegh quoted Assistant Secretary of State Clayton and Professor Edward Mason as saying that the United States must reduce its tariffs to enable foreign countries to repay our loans and said he believed we must decide on such a policy before accepting Bretton Woods.

Mr. de Vegh objected to the allocation of large Fund quotas to Russia and China, and the fact that nothing has been done to solve the British balance of payments problem. He favored large direct investments in England by American corporations. Action on our part to relieve England of her armament burdens by promising to defend the British Empire is the only alternative to consolidation of the British Empire and Western Europe into one large economic unit. The latter is inimical to American interests.

Mr. de Vegh said he believed the currency experience of the inter-war years proves that the hopes raised by Bretton Woods cannot be fulfilled. American foreign lending for 11 years after the last war only succeeded in keeping reasonably stable exchanges for about four years and the cessation of lending was followed by catastrophe. Lending cannot solve the problem of war devastation. The Bretton Woods plan is a "nostalgic plan" that leaves problems unsolved, the war has resulted in tremendous shifts and there is no common

ideological ground between the various groupings of countries that will eventually emerge. Another difficulty is that the United States will be held responsible for making the Fund work. There is no chance of countries living up to their obligation on exchange rates and exchange restrictions after the money gives out. Also the Fund will stimulate reckless spending by borrowers and the principle of non-interference with domestic policies will prevent action to prevent such developments.

Mr. de Vegh then said the Bank was good business in the sense that it would pay for itself but not the Fund. He said the Fund management had little discretion and the implied safeguards talked of by the Treasury should be made explicit. If foreign countries have agreed to letting the management exercise discretion they should not object to interpretative amendments. The Fund should not operate in the transition period or at least only on a very restricted basis.

Mr. de Vegh summarized the steps which he believed essential to the success of the Agreements and still possible but emphasized that they could not assure success. He advocated postponing action on the Fund to the last moment, clarifying our trade policy and getting clarification from foreign countries, negotiating comprehensive economic agreements with England and the Dominions at least and as many other countries as possible before ratifying Bretton Woods, giving the Bank power to make stabilization loans, amending the Fund agreement to give the management power to turn down questionable loans, restricting use of Fund to 5 per cent of quota per year for the first four years after V-J day, avoiding "risk of a deadlock" if can't create conditions in which the Fund can function successfully and, unless the Fund plan is so altered, giving 3 billion dollars to the Export-Import Bank for granting short-term foreign exchange credits.

Rep. Buffett (R. Nebr.) said he agreed with a good deal of Mr. de Vegh's statement. He asked whether foreign countries would not try to use up their quotas quickly before prices had risen too far in this country. Mr. de Vegh said he thought they would try to do so in any case and that it was one of the worst difficulties of the Fund that it would be impossible to distinguish between legitimate foreign exchange needs and foreign exchange needs for reconstruction and rebuilding of inventories. He did not think that foreign demands would be a decisive factor in our own domestic price structure as suggested by Rep. Buffett but said they might be critical. Rep. Crawford indicated he was greatly worried about post-war controls in the United States and Rep. Buffett suggested there was no alternative to regimentation with a huge government deficit. Mr. de Vegh said large government expenditures did mean necessarily a large element of government control and said he believed there were great difficulties in the way of free private enterprise after the war.

Rep. Riley (D. S.C.) asked if coordinated efforts at solving our problems would not be better than haphazard individual action. Mr. de Vegh agreed but said there were many alternatives to a global agreement. Rep. Riley said he believed the agreements reached at Bretton Woods were a good start. Mr. de Vegh said the Fund could not be defended as a means of increasing exports and commented that public works would serve equally well to stimulate employment and would also raise our standard of living.



Rep. Talle (R. Iowa) asked Mr. de Vegh to define fundamental disequilibrium. Mr. de Vegh mentioned Cassel's purchasing power parity theory, Lord Keynes' criticisms of it, and Lord Keynes' statement that Britain needed a change in rates in 1931 because interval costs were too high. He said there was no formula for deciding what is equilibrium and what is disequilibrium and also no formula for deciding when a disequilibrium is fundamental. On this account Mr. de Vegh believed there should be a clear statement in the Fund agreement as to what is proper and what is improper lending. Rep. Talle asked Mr. de Vegh to describe how he would limit the Fund's activities. Mr. de Vegh said the Fund should give short-term credits but not stabilization loans. Stabilization loans are long-term and should provide currency reserves for future contingencies. The Fund should use its reserves to cushion the impact of a sudden deflation abroad. Mr. de Vegh said he believed the Fund could have helped England in 1931 by giving credits and permitting a once and for all 10 per cent deflation. In reply to further questions by Rep. Talle Mr. de Vegh said he believed that identity of the Fund and Bank management would be desirable and that as the Fund agreement stands more dollars would have to be provided either through or outside the Fund.

Rep. Folger (D. N.C.) asked Mr. de Vegh if he approved of the Bank and Mr. de Vegh said that since there was a strong majority of opinion in favor of it he thought it was unnecessary to start a controversy over it at this late stage. In reply to another question by Rep. Smith Mr. de Vegh said the Fund should not have the stabilization function -- this function should be made that of the Bank. When Rep. Smith said whatever loans were made should be predicated on foreign countries putting their houses in order, Mr. de Vegh said he agreed in general and would certainly scrutinize each loan.

Rep. Crawford said he thought Mr. de Vegh's statement had been a very valuable contribution and that he agreed with Mr. de Vegh that the whole financial arrangement should have been postponed. He said he was satisfied that the Committee would report the bill favorably and that it would go into operation and we would have to "muddle through as best we can". He believed there was a 40-60 chance of getting some kind of an amendment to this proposal before it went to the House but he was not too enthusiastic about that.

Board of Governors  
of the Federal Reserve System  
Division of Research and Statistics  
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