

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

May 11, 1945

(Twenty-eighth day of hearings)

Before testimony was resumed, Representative Smith (R. Ohio) asked the unanimous consent of the Committee to insert in the record a study which he had made showing that Lord Keynes really wrote the Fund Agreement. Chairman Spence (D. Ky.) declared that he would consider it improper to receive testimony on "matters of hearsay" and referred decision on the acceptance of Rep. Smith's study to an executive session of the Committee which would have a right to investigate it.

Dr. O. M. W. Sprague, professor emeritus of Harvard University, testified for the acceptance of the Bank and the Fund. He said that he did not understand the position taken by some witnesses, that the Bank should be established but not the Fund. He declared that if he harbored all the fears that have been expressed about the Fund he would be almost more disturbed about adopting the Bank proposal. If foreign exchanges are to be in disorder, and if countries are to use their Fund quotas "like drunken sailors," the bonds floated by the Bank will not be very satisfactory issues.

He then took issue with critics of the Fund who advocate a return to the gold standard. He said that the expectations on which the return to gold after the last war was based were not fulfilled. The gold standard did not lead to permanent recovery or to a restoration of general equilibrium. It broke down in times of peace. Since the departure of various countries from gold two important developments have taken place which would impede the success of a return to gold. During the 'thirties an immense amount of experience was gained in speculating against weak currencies and business concerns having commitments in foreign countries engaged more than ever in covering their foreign exchange risks. Speculation and hedging transactions would exercise exceedingly heavy pressure on foreign currencies. The fact that nearly all countries financed the war at low interest rates makes it impossible for these countries to protect their currencies through an increase in the discount rate.

He commented on the rigidity of exchange rates under the gold standard and said that slight changes in exchange rates, as provided for in the Fund Agreement, would be helpful. We are likely to get more stability with a moderate measure of elasticity than if we aim at complete rigidity.

Dr. Sprague then referred to the permissibility of exchange restrictions under the Fund Agreement, and said import restrictions would have to be maintained for an uncertain period of time because of the intense demand for imported goods in some countries and in order to allow time for the reconstruction of export industries. He said that records and reports of exchange transactions would have to be maintained in order to distinguish between capital movements and trade transactions.

Referring to the emphasis which has been put on the use of Bank loans and guarantees for productive purposes, he said that productivity alone was no assurance that the borrowing country could meet interest and amortization obligations. In a system of disorderly exchanges and bilateral clearing agreements few productive foreign loans would be secure. The Fund is absolutely necessary to secure a reasonably orderly development in monetary arrangements, a minimum of restrictions on transfers, and a minimum of bilateral and other special arrangements between countries. If we do not have the Fund most countries would take the view that the only

ments. The Fund holds out hope that the world will move toward more universal trading arrangements.

Dr. Sprague then discussed the use of the Fund quotas. He said that quotas are comparable to gold reserves or foreign balances of central banks. They are drawn upon if an unfavorable balance in international transactions develops. There is no sound reason for supposing that countries would adopt a more reckless policy because of the Fund than they would in the absence of the Fund. Besides, there are important safeguards against misuse of the Fund. One is the publicity of the annual and quarterly reports of the Fund. Few countries would regard with equanimity the exhaustion of their limited quotas in a short period of time. Another is the fact that many countries drawing on the Fund may wish to resort to the Bank for long-term loans. In considering a long-term loan to a member the Bank would certainly attach importance to whether the member seemed to be making reckless or improvident use of its Fund quota.

The greatest difficulty which may present itself in the working of the Fund is the danger of excessive purchases of American products immediately after the war. The establishment of the Fund may permit somewhat greater exports from the United States for a short period of time than might otherwise be the case. Only if some foreign countries used their quotas improperly would United States exports expand more than is necessary to meet the vital needs of the world. Nothing is to be gained from a large increase in exports if that increase cannot be maintained. Therefore, we should regard with favor the maintenance of trade restrictions in other countries which will permit them to make necessary adjustments and begin to produce in a normal fashion.

Discussing the possibility of a scarcity of dollars Dr. Sprague said that if dollars became scarce it would not be because of the Fund but because of excessive purchases of American goods. Dollars might become scarce with or without the Fund but he was inclined to believe that a scarcity of dollars would be less likely to occur if we had the Fund.

In reply to a question by Chairman Spence, Dr. Sprague said that it would be ten or more years before we could go back to a fixed gold standard. Rep. Buffett (R. Nebr.) asked whether the Fund and the Bank would not increase the danger of inflation in this country. Dr. Sprague answered that he did not think our exports would be excessive in the next few years. The volume of goods which foreign countries will need for reconstruction is frequently exaggerated. Only if foreign countries removed their trade restrictions would there be no limit to their demand for American goods. But there is no evidence of their intention of abolishing them. Rep. Buffett then asked whether we did not need definite safeguards to ensure that the Fund would be used only for short-term purposes particularly in the case of Russia. Dr. Sprague referred to his previous statement that countries would be reluctant to make excessive use of the resources of the Fund because they would have difficulty in getting loans from the Bank. The influences which will induce the Russians, who presumably will want long-term loans from the Bank, or any other country to use the resources of the Fund with judgment are pretty strong, about as strong as one can get them in any complicated business situation.

In reply to a question by Rep. Thom (D. Ohio) Dr. Sprague said that the Fund offers a better chance of getting unified and concerted action than if we attempt to deal with each country individually because the situation of any particular country will be largely affected by the actions of other countries. Under the Fund Agreement, countries will move along together just as if we provided all

countries with a modest gold reserve to start with. Rep. Thom asked Dr. Sprague to comment on the criticism that the Fund Agreement is loosely worded. Dr. Sprague said that in view of the complicated transactions in the foreign exchange market, the agreement could not be very specific. He referred to the Federal Reserve Act which covers the complicated relation between the Treasury and the Federal Reserve Banks in one simple sentence.

Asked to comment on the proposal that the operations of the Fund should be postponed until more orderly conditions prevailed in the world, Dr. Sprague declared that he disapproved of that position because in the intervening period all sorts of clearing and special arrangements between individual countries would be established. Once such agreements exist, they become vested interests and more or less insuperable obstacles. If people are not consciously working toward the gold standard, it is not just going to emerge by itself by waiting and doing nothing. Today the desire to return to the gold standard which was strong after the last war does not exist. If it did, the Fund would be unnecessary.

Representative Brumbaugh (R. Pa.) asked whether the nations of the world today accept international bimetallism. Dr. Sprague replied that the large increase of gold production has eliminated or weakened one of the arguments for bimetallism, that of insufficiency of gold. For the western world it is not an important problem. It does not affect the ability of most countries to meet their current foreign payments. Rep. Brumbaugh further asked about the advisability of putting the Bank and the Fund under one management. Dr. Sprague said he did not know whether this would be desirable, but perhaps a good case could be made for it because it may become rather difficult to get adequate management for the two institutions. In this connection he mentioned the proposition that the Bank should be authorized to make stabilization loans. He said that it was not at all clear what was meant by these stabilization loans. Stabilization loans such as those made during the 'twenties were simply a kind of guarantee to a country returning to the gold standard. There is no immediate occasion for loans of this type because at present there is no intention of establishing a rigid gold standard. If what is meant by a stabilization loan is credit for the purchasing of raw materials, such loans could be made through the Bank. If the functions of the Bank were expanded in this fashion it might be better to keep the Bank and the Fund management separate.

Representative Smith questioned the witness as to the probability of currencies being valued at their proper value when the Fund goes into operation. Dr. Sprague declared that many currencies would have to be adjusted within the 10 per cent range. As examples he mentioned Latin American countries which may experience a contraction of their exports. He added that the Fund is not to be used to meet deficits caused by fundamental changes. Use of the Fund is merely evidence of a situation that needs correction. He added that parity changes would take place anyway. The permissibility of changes under the Fund Agreement will not mean that more changes will be made than if we did not have the Fund. Rather a smaller number of changes and less extensive changes will take place. The Fund Agreement will however protect against unnecessary changes in parities.

The testimony of Dr. Sprague ended the hearings before the House Banking and Currency Committee.

Board of Governors
of the Federal Reserve System
Division of Research and Statistics
May 12, 1945