BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 9, 1947

To Chairman Eccles

From Mr. Knapp

Subject: National Advisory Council meeting to be held tomorrow morning.

JM

I should like to give you the following comments on the items to be considered at the National Advisory Council meeting tomorrow.

(1) International Bank operations in its securities. The Staff Committee is recommending the approval by the Council of a letter from Secretary Snyder to Mr. Garner containing the following paragraph:

> "I hereby confirm that the Government of the United States has approved, and hereby does approve, in accordance with Section 8(i) of Article IV of the Articles of Agreement of the International Bank for Reconstruction and Development, the buying and re-selling from time to time by the Bank in the United States market of any bonds or other obligations which it shall have issued or guaranteed, subject to the condition that the Bank inform the Federal Reserve Bank of New York, as agent for the Federal Open Market Committee and as fiscal agent for the United States Treasury, concerning its programs of operations under this authorization, and keep the Federal Reserve Bank currently advised as to purchases and sales made thereunder."

I believe that this proposed action is fully responsive to the request made in your letter of July 3 to Secretary Snyder on behalf of the Open Market Committee.

I have discussed with you the Treasury's proposal that the Federal Reserve Bank of New York receive information concerning the Bank's stabilization operations as fiscal agent for the Treasury as well as as agent for the Federal Open Market Committee and I understand that you are not inclined to oppose this idea.

(2) Application to British Colonies and Mandates of the principle of non-discrimination in British trade. Section 9 of the Anglo-American Financial Agreement provides that with certain limited exceptions the United Kingdom will administer its quantitative import restrictions in such a manner as not to discriminate against imports from the United States. Furthermore, in a letter from Lord Halifax to Secretary Vinson which was written during the negotiations, the British undertook to exercise their best efforts to cause their Colonies and Mandates to observe the same principle.

The question has arisen, however, of whether this general principle of non-discrimination is supposed to cover trade among the United

Kingdom, its colonies and mandates. The British have taken the position that it does not; that in the commercial policy discussions which paralleled the loan discussions in Washington the principle was fully accepted that a country could discriminate in favor of its own dependent areas; and that this principle has been fully accepted by the United States in all subsequent discussions of the International Trade Charter. After considerable discussion, the Staff Committee is recommending that the British view be accepted. It is my personal recollection that at the time of the loan negotiations we all recognized that no attempt was being made to break down the special trade relations between the United Kingdom and its dependent colonial areas. The British dominions, of course, are not in this position; the British recognize that the United Kingdom (and its colonies) are bound not to discriminate against U.S. exports in favor of Canada, India, South Africa, Australia, and New Zealand.

While we seem to have no rights under the Anglo-American Financial Agreement to insist on equal treatment in trade within the colonial empire, we do have the general right to make representations to the British concerning commercial policy matters, and we have a specific right under the League of Nations Mandates Agreements to demand equal treatment for our trade in British mandated areas. The State Department plans to exercise these rights in negotiations with the British in order to secure better treatment for our trade than the British presently contemplate. On the whole, however, I cannot get too much excited about this question; the colonies and mandates are dependent upon the British for dollars, and if the British desire to use their scarce dollars for imports into the United Kingdom rather than into the colonies or mandates, I do not think we have very strong grounds in equity for complaint.

(3) British request for limited postponement of convertibility obligations. You will recall that under the terms of the Anglo-American Financial Agreement the United Kingdom is required to arrange by July 15, 1947 that sterling accruing to third countries after that date (or released from sterling balances accumulated before that date) shall be freely available for current transactions in any area of the world.

There is a provision for postponement of the effective date of this commitment "in exceptional cases" by agreement of the parties, and on July 7 Secretary Snyder received a letter requesting such a postponement in certain cases.

The Staff Committee has completed its investigation of these rather complicated matters and is presenting a series of recommendations which I shall quote and then explain briefly.

Before doing so, however, I should like to give you an idea of the technique which the British are using to implement their obligation.

Essentially this technique is simple. The British will establish so-called "transferable accounts" for each country with which they trade, into which would be paid the sterling proceeds of exports to the United Kingdom (and the rest of the sterling area) from the country concerned. Sterling credited to such accounts will then become freely transferable in payment for current transactions to any other country holding such an account. In general the accounts will be held by the central bank of the country concerned, which will agree to use the account only for current transactions; it will also agree to accept payment in sterling from third countries on current transactions. This transferable sterling can also be sold by any holder in the New York market, where any net offerings will be purchased for dollars by the Federal Reserve Bank of New York, acting as agent for the Bank of England.

In short, as soon as the British have negotiated a transferable account arrangement with every country in the world, sterling will automatically become freely usable in current transactions in any currency area. The British could have achieved the same objective by offering to convert into gold or foreign currencies any sterling paid by the United Kingdom (or the sterling area) to foreign countries on current account. However, the present system has great advantages from the British point of view: it encourages foreign countries to keep working balances in London; it thereby encourages foreign countries to use British banking and other financial services; and in general it restores the pound sterling to its place as a leading world currency.

The Staff Committee's recommendations are as follows:

(a) Favorable consideration should be given to granting the British request of a maximum of two months' postponement of the July 15, 1947, deadline in those cases where it is impossible for the British to complete technical arrangements with the particular countries before July 15. In these cases, the Secretary of the Treasury should attempt to secure an agreement that all sterling accruing to these countries after July 15, 1947, shall become freely available for current payments retroactively upon the date of completion of the necessary arrangements.

This recommendation is more or less self-explanatory. The British claim that they have not yet completed their negotiations setting up the transferable account system for a number of countries (mostly in Eastern Europe) and have requested only a brief extension of time to permit the necessary arrangements to be made.

(b) The British request for an indefinite postponement with respect to China should be denied. The British should be informed that, while the U.S. Government is conscious of the difficulties which will be faced in administering Chinese accounts, it trusts that the British Government will make every effort to insure that applications to transfer sterling will be freely granted whenever the current nature of the transaction is established.

The British argue with respect to China that conditions there are so chaotic and communication so uncertain that they cannot, as a matter of practice, distinguish successfully between capital and current transactions and therefore cannot fully live up to their obligation to make China's sterling freely usable for current transactions. They therefore requested an indefinite postponement of their obligation in this respect. The Staff Committee is quite sympathetic with the British position, but feels that instead of granting a formal postponement, we should hold them to the Agreement, but inform them in effect that we realize they will be unable to discharge it fully and completely.

(c) The British should be advised that in the case of other non-sterling area countries with which no formal transferability agreements are contemplated, they will be expected to administer their foreign exchange control in such a way as to permit transfers freely for all current transactions.

This covers an odd list of countries like Afghanistan, Albania, Korea, ietc., for which the British do not propose to set up any formal transferable account system. There is no reason to believe that the British would not readily accept the requirement laid down in this action.

(d) The British request for an indefinite extension for Switzerland until that country agrees to accept sterling and set up a Transferable Account System should be denied, but favorable consideration should be given to a request for a postponement of short duration as in paragraph (a) above, which would allow the British time to complete whatever arrangements may be necessary.

The British argue that their negotiations with Switzerland for a transferable account arrangement may break down because the Swiss do not want to accept an obligation to <u>receive</u> sterling in payments from third countries. It is not clear (a) why the Swiss should refuse this, or (b) why the British should insist upon it. In any case, the Staff Committee does not regard this as a legitimate reason for granting the British an indefinite extension in their obligation to make Swiss sterling freely usable. The British obligation in the Financial Agreement is unconditional, and if they do not want to give the Swiss a transferable account there are other ways in which they can live up to their obligation (e.g. offer to convert Swiss sterling upon demand into gold or third currencies required for current transactions). However, the Staff Committee does think that it would be reasonable to give the British a short extension in this case so that they may complete other arrangements.

(e) The British should be informed that arrangements relating to the debts of those countries which are indebted to the United Kingdom should be effected by means which do not limit the transferability of sterling for current transactions.

The British propose in the case of countries such as France, which owe large amounts to the United Kingdom on clearing accounts, to inform those countries that any surplus sterling which they may acquire in transactions with the sterling area should be used to repay these debts rather than for payments on current account to third countries. The British dress up their argument very nicely, but the Staff Committee is convinced that such arrangements would be contrary to the British obligations in the Financial Agreement. We recognize at the same time that the British can effectively accomplish their objective through other devices which would not be in conflict with the Agreement. It is recommended, therefore, that in order to save both ourselves and the British some embarrassment, the British turn to these other devices instead of requiring another exemption from their obligations.

(f) In the event that additional requests are made by the British in the immediate future, the Secretary of the Treasury should, in considering his reply, take account of the general approach set forth above.

No comment.

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There are some additional matters on which the British have made no request for extension of time, but on which we are still uncertain as to British intentions. The Staff Committee therefore suggests that when the matters covered above are discussed with the British, the opportunity be taken to request additional information on these points.