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Files

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S E C R E T

The French Government (Council of Ministers) has decided to request the approval of the International Monetary Fund for a substantial devaluation of the French franc, accompanied by the institution of a "floating rate" for most transactions with the dollar area. This matter is being taken up in advance with the U.S. Government through the Treasury, and the senior N.A.C. staff members, together with Mr. Overby and Mr. Luthringer, have been meeting in executive session to consider what attitude the U.S. Government should take. We have now met twice and will meet again this afternoon; we are having great difficulty in reaching agreement among ourselves.

Briefly the French proposal is as follows:

1. To devalue the franc by 80 per cent with respect to all "soft currencies". This means that the new rate on these currencies would correspond to a dollar rate of 214 francs. The French propose to declare this rate as their new "par value" in the Fund.

2. To institute a "floating rate" for the U.S. dollar and other "hard currencies" (at present the Portugese escudo and the Swiss franc). An open market would be established in France for the dollar (and other "hard currencies") in which exporters to the dollar area would be permitted to sell 50 per cent of their dollar export proceeds (the remaining 50 per cent would have to be sold to the government at the official parity). In addition, those receiving dollar payments for services (especially from the tourist trade) and persons repatriating dollar capital from abroad would also be allowed to sell their dollars for francs in this open market. All importers from the dollar area (except importers of coal, wheat, fertilizer, and petroleum--see below) would have to buy their dollar exchange in this market. Although imports from the dollar area would continue under license, it is apparently expected that this demand for dollars would be sufficiently large in relation to the supply to assure the establishment of a substantial premium for the dollar in the open market.

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It is essential to the plan that a premium arise, because only through a premium would recipients of tourist dollars and persons repatriating capital be induced to sell their dollars for francs. It should be recognized, therefore, that this would be a controlled premium, and not in any sense a premium arising out of the operation of a "free market". The French Government could raise (or lower) the premium by allocating fewer (or more) import licenses. It might also intervene directly in the market, for example, by selling in the market dollars obtained from exporters (amounting to 50 per cent of dollar export proceeds).

3. To retain the rate of 119 francs to the dollar with respect to imports payable in dollars of specified essential commodities (coal, wheat, fertilizer, and petroleum products) in order to prevent the inflationary increase in franc prices of these commodities which would occur if they were imported at the new official rate.

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In considering this proposal, we (the U.S. technical group) have broken the problem into two parts: (1) is it necessary for the French to adopt differential rates of exchange for exports, and (2) is it necessary for them to institute an open market for dollar imports, dollar invisibles, and dollar capital repatriation.

With respect to the first question, we have reached agreement that as a minimum we should object to the allocation of 50 per cent of dollar export proceeds to the open market. The effect of this, assuming that the open market dollar rate is around 300, is to make the effective rate of exchange on dollar exports 257 (half at 214 and half at 300). The French argue that they need a relatively higher rate on dollar exports than on exports to "soft currency" countries; they point out that "soft currencies" are in turn over-valued in relation to the dollar, and that appropriate adjustment to the "soft currencies" would still have the franc over-valued vis-a-vis the dollar. While granting the logic of this position, we feel that complete chaos would develop in international exchange rates if each country were allowed to adopt a discriminatory system of exchange rates based upon the presumed over-valuation or under-valuation of each foreign currency. The only real answer to the problem is devaluation of the other "soft currencies", which may in fact follow fast if the French now act. Furthermore, while it would undoubtedly be desirable to stimulate French exports to the dollar area, we doubt whether more than 1-2 million dollars of additional exports per month would develop as a result of the proposed special premium on dollar exports.

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If half of the dollar export proceeds no longer flowed to the open market, it would be necessary, in order to preserve the balance in that market, to withdraw from it an equivalent amount of demand by importers. In other words, instead of all importers (other than of the specified essential commodities) having to buy their dollar exchange in that market, some importers (presumably of additional essential commodities) could be allocated dollar exchange at the official rate.

On the second question, there is considerable difference of view. In general, Norman Ness of the State Department and I are very skeptical as to whether the "floating rate" system is justifiable at all. If 50 per cent of the dollar export proceeds were not sold on the open market, that market would become simply a device to assure that certain importers from the dollar area would pay the premium required to induce offerings from recipients of tourist dollars and persons repatriating dollar capital, and pay the cost of subsidizing the specified essential imports. (The government, which would be buying all dollar proceeds of exports at the official rate, could sell some of these proceeds on the open market at a premium in order to cover its losses from the subsidy exchange rate granted to importers of specified essential commodities.)

In short, the whole differential exchange rate system would be revealed as simply a fiscal device. Exactly the same purposes could be accomplished through the imposition of special duties on certain imports from the dollar area, and the payment by the government of straight subsidies to importers of the specified essential commodities and outright bonuses for dollars originating from the tourist trade or from capital repatriation. However, (1) the government has only recently abandoned most of its internal subsidies, and would be reluctant to resume this practice openly; and (2) it might be quite awkward for them to pay an outright bonus on "tourist dollars" and "capital dollars".

These circumstances apparently incline the Treasury to be willing to accept the French proposals (as modified with respect to exports). However, my feeling is that the French government ought to subsidize imports of the specified essential commodities through a tax on certain imports from the dollar area, and try to recapture tourist dollars and capital abroad through direct action rather than exchange rate inducements or bonuses in other forms. Here again Mr. Ness and I are in agreement that the French holders of "tourist dollars" and of dollar capital located abroad will probably not be induced to give up their dollar holdings through exchange rate premiums or other bonuses.

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