EXECUTIVE DIRECTOR

INTERNATIONAL MONETARY FUND
WASHINGTON 6, D.C.

CABLE ADDRESS
INTERFUND

January 30, 1948

Dear Marriner:

In view of the apparent confusion in the public press regarding the International Monetary Fund's attitude on the recent changes in the French monetary system, you may be interested in glancing at the attached letter which I have sent to Congressman Brent Spence, in response to his inquiry, explaining our position on this subject.

Sincerely yours,

Andy

A. N. Overby
U. S. Executive Director

Mr. Marriner S. Eccles
Vice Chairman of the Board of
Governors
Federal Reserve System
Washington, D. C.

Enclosure

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INTERNATIONAL MONETARY FUND
WASHINGTON 6, D.C.

EXECUTIVE DIRECTOR

CABLE ADDRESS
INTERFUND

January 28, 1948

My dear Congressman:

I am glad I had an opportunity to discuss with you on the phone this morning the recent changes in the French monetary system, regarding which there has been so much discussion in the public press and not a little confusion.

As I indicated to you, the International Monetary Fund heartily agreed with the French Government that a change in the par value of the French franc was necessary, and indicated that it was prepared to concur in a devaluation of the franc to a realistic rate. I think I can fairly say that officials of the International Monetary Fund, including myself, have for several months indicated to the French Government officials that a change in the value of the franc was necessary and desirable. We have all indicated for several months that this action should be preceded and accompanied by budgetary and fiscal measures directed at internal monetary stabilization, without which a devaluation of the franc would prove ineffective, if it did not actually contribute to further inflationary forces. In all of our discussions with the French authorities over the past several months we have urged them to take measures to balance their budget, to improve and strengthen their tax collection measures, to control inflationary expansion of credit, to reduce wherever possible their capital investment program, and to take all other measures necessary to bring under control and reduce inflationary factors at work in France. We have noted with satisfaction that the French authorities, despite the fact that such measures are often unpopular, at least temporarily, have in recent months taken budgetary and fiscal measures directed at internal monetary stabilization.

You will note that the attached press release by the International Monetary Fund emphasizes the foregoing considerations and I should like to re-emphasize that we were all prepared to concur in a devaluation of the franc to a realistic rate. This was not the point at issue.

I think I might elaborate somewhat on the description of the French monetary plan which is contained in the attached press release. The French proposed to reduce the official par value of the franc by 44.444 percent. This would result in a change of the rate from approximately 119 francs per U.S. dollar to approximately 214 francs per U.S. dollar, from 480 francs per £ sterling to 864 francs per £ sterling, etc. At the same time the French proposed to introduce a so-called "free" market in which the U.S. dollar, the Portuguese escudo, and ultimately certain other currencies would be bought and sold in a market inside France at fluctuating rates which would differ considerably from the new official par value.

This new "free" market would not be a free market in the orthodox, classical sense because it would be subject to the control of the French authorities in the granting of import licenses, in authorizing capital transfers, etc.

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French exporters to the dollar area, for example, would be required to sell one-half of their export proceeds to the French monetary authorities at the new official par value of 214 francs to the dollar. They would be permitted to sell the other one-half of their export proceeds in the "free" market. Assuming this "fre market would be established in the neighborhood of recent quotations in the black market of, say, 340 francs to the dollar, the French exporter to the dollar area, selling one-half of his export proceeds at the official par value of 214 and one-half at the "free" rate of 340 would average 277 francs per dollar of export proceeds

The French authorities proposed that so-called basic commodities, such as wheat, coal, fertilizer and petroleum products, would enter France at the official par value of 214 francs to the dollar. These commodities are the basic commodities which are being supplied under the Interim Aid Program and would presumably continue to be supplied under the European Recovery Program. Importers of so-called non-basic commodities would be required to purchase their dollar exchange in the "free" market at a rate of, say, 340 francs to the dollar.

The "free" market would also be used for various "invisible" transactions which would be authorized to take place in this market, including exchange transactions of tourists, capital transfers and other non-commercial remittances. It was the hope of the French authorities that the "free" rate would encourage a substantial repatriation to France of French capital held abroad.

As I have said, the Fund was more than prepared to agree to a change in the par value of the franc to a realistic rate and the Fund did its utmost, in view of the special circumstances prevailing in France, to go along with the French propos Despite certain misgivings regarding a system involving fluctuating rates, the Fund was prepared to accept the fluctuating "free" market for "invisible" transactions and even for the import of non-basic commodities from the dollar area.

The one point on which the Fund was unable to approve the French proposal was the inclusion in a market with fluctuating rates of any part of the proceeds of exports, as in its judgment this entailed the risk of serious adverse effects on other members of the Fund without being necessary to achieve the trade objectives sought by the French authorities. As stated in the press release, "The Fund felt that there would be scope for competitive depreciation in the application by one country of a fluctuating rate on exports to one area while other rates remained stable and other countries maintained the parities agreed with the Fund. Such a system, operating in an important trading country, would encourage trade distortions and might cast unwarranted doubt on the real strength of many currencies through the apparent discount applied to them in the French system. The Fund feared that the widespread adoption of such a system would result in exchange uncertainty and instability and produce a disorderly exchange situation from which all members of the Fund would suffer."

Granting permission to France to sell the proceeds of exports to certain areas (e.g., the dollar area) at a fluctuating premium with respect to the cross-rate based on Fund parities, which other members would be required to observe, would make it possible for the French to engage in competitive depreciation at the expense of other members of the Fund and without control by the Fund. One of the basic purposes of the Fund is to prevent such competitive depreciation.

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It was felt that if export proceeds were sold in this manner serious trade distortions might result, either from the price effects of the fluctuating exchange differentials or from the actual diversion of trade from its customary channels through commodity arbitrage. For example, French importers might purchase goods in the sterling area or in other currency areas which could then be re-shipped to the dollar area and sold at a substantial profit, thus in effect, depriving the sterling and other areas of the dollar proceeds of the sales that they might otherwise normally make in the dollar area. Although the French indicated that they would use their best efforts to prevent this, question existed in the minds of the members of the Fund as to whether they could in fact do so. Moreover, it was thought that even if the French authorities could control such commodity arbitrage, similar effects might follow indirectly from price distortions arising from the differential exchange rates.

The Fund did not see how it could deny to other countries the right to institute fluctuating rate systems if France were allowed to do so. If the Fund, under the French proposal, required other members to live up to their obligations under the Fund Agreement, we would be permitting a particular country to gain advantages from instituting a fluctuating rate system. If many members institute fluctuating rate systems, however, a wholly new situation is created in which the stability and order in exchange rates which are one of the objectives of the Fund become difficult, if not impossible.

One of the results of the French proposal, if adopted on a widespread syste would be to promote bilateral deals and reduce world trade more and more to a barter basis, which is contrary to the objectives of the Fund and of U.S. policy in the foreign economic field.

Although the introduction of the French system raises many difficulties and may have serious adverse consequences, we are all hopeful that the French Government and other governments, particularly the neighboring European countries, will do everything within their power to keep to a minimum the adverse consequences which may flow from the French action. In this connection I think you may be interested in the attached Anglo-French communique and in the French communique on this matter.

The Fund for its part, while regretting the French action, will continue to work with France in seeking a modification of its newly introduced exchange practices in order to meet French needs within the framework of the international monetary arrangements established by the Fund Agreement.

As our statement emphasizes we have approached this problem in anything but a rigid and doctrinaire manner, and as you will see from my description of the extent to which we were willing to go, we certainly are not holding to any "pet" ideas or rigid concepts. The Fund was established essentially to set up rules of fair practice in the international monetary field. We have no desire to be "managers Our efforts, on the contrary, are directed toward the role of a benevolent umpire, who is anxious to have the members of the Fund adhere as closely as possible to the rules of fair play which it was sought to establish in the Fund concept. The competitive exchange depreciation, exchange instability, and Schachtian economic warfare practices of the "Twenties" and "Thirties" were among the evils which it was hoped the Fund would be effective in removing. We are still hopeful that, despite the present difficulties of the world, we can promote standards of fair

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exchange practices and gradually remove, rather than increase, exchange restrictions and competitive or discriminatory exchange arrangements. I know that the members of the Fund Board and the Staff of the Fund are devoting their full energies and best judgment to the success of this experiment in international cooperation, and that they will do their utmost to carry on despite temporary setbacks.

Please forgive me for having written at such length, but I wanted you to have an understanding of our point of view and of our objectives. If you have any questions, I shall do my best to answer them for you.

With all good wishes and the hope that I may have the pleasure of seeing you soon again, I am,

Sincerely yours,

(Signed) A. N. Overby

A. N. Overby
U. S. Executive Director

Honorable Brent Spence
House of Representatives
Washington, D. C.

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