REPERCUSSIONS ON RESERVE SYSTEM OF BRETTON WOODS INSTITUTIONS 2/13/46

The payment of the United States subscriptions to the International Monetary Fund and the International Bank for Reconstruction and Development, and the subsequent operations of these institutions, will have important repercussions on the Federal Reserve System and the monetary and credit structure of the United States. They will have certain direct effects on the reserves and deposits of the System, but of more fundamental significance will be the influence of these institutions upon the international transactions of the United States and, therefore, on the monetary and credit structure of the country. Also the System will have certain relatively routine agency and depository functions to perform on behalf of the Bretton Woods Institutions and may desire to consider undertaking a more positive role, at least in connection with the marketing in this country of International Bank securities.

Direct Effects on Reserves and Deposits

Fund. The principal effect of the United States subscription to the International Monetary Fund will be a large increase in the amount of gold certificates held by the System. There will also be a large initial but mainly transitory increase in the deposits of the Reserve Banks. Thereafter the additional deposits resulting directly from the existence of the Fund will be limited to the dollar working balances maintained by that institution, which will probably amount to only a few hundred million dollars.

The United States subscription to the Fund is $2,750 million. Of this amount $1,800 million is to be financed from gold now held inactive by the United States Stabilization Fund and $950 million will be borrowed by the Treasury. The potential addition to Federal Reserve and member bank reserves all lies in the $1,800 million which arose out of the gold increment from devaluation of the dollar in 1934 and which hitherto has been held unused. One-quarter of the total U.S. subscription, $687.5 million, must be in the form of gold, and it will presumably be held in that form by the Fund for some time. Hence $1,112.5 million of the $1,800 million will be immediately converted into gold certificates and contributed to the Fund in the form of dollars. 1/ Of this amount the Fund will retain a reasonable working balance of, say, $300 million and the rest must be turned back to the U.S. Treasury, at its request, in exchange for non-interest bearing demand notes. The amount of around $800 million which may thus revert to the Treasury will increase member bank reserves to whatever extent the Treasury spends it. Similarly, if the Fund in due course converts the $687.5 million U.S. gold contribution into dollars to meet the demand for dollars on the part of foreign countries, a corresponding amount will be added to

1/ This $1,112.5 million of certificates will be added to reserves of the twelve Federal Reserve Banks in exchange for a corresponding addition to Treasury deposits which will then be drawn upon in favor of the Fund as part of the U.S. subscription.

member bank reserves. The potential addition to member bank reserves, therefore, from the U.S. subscription is about $1,500 million, if the Fund holds a regular working balance of about $300 million. Since it can always replenish its working balance by calling in the demand notes of the United States or selling gold to the Treasury, there seems to be no reason to hold a much larger balance.

The $950 million which will be borrowed in order to complete the U.S. subscription will immediately be returned to the Treasury in exchange for its non-interest bearing demand notes. The smoothest method to handle this transaction would be for the Treasury to borrow this $950 million from the Federal Reserve Banks and repay the debt out of the funds returned. Such an operation would have no effect on member bank reserves.

In the course of the future operations of the Fund, there will be no significant direct effects on Reserve Bank reserves and deposits so long as no large fluctuations occur in the dollar working balances of the Fund. However, as foreign countries buy dollars through the Fund, that institution will have to replenish its dollar balances from time to time by calling upon its holdings of Treasury demand notes. The Treasury's financing of these disbursements will have the same effects upon the money and credit situation as in the case of any other Treasury expenditures, depending upon the methods by which the necessary funds are raised.

Bank. The U.S. subscription to the Bank is $3,175 million but only $63.5 million is to be paid-up initially. An additional $571.5 million is likely to be called up from the United States during 1946-47, but further amounts can be called only if necessary to meet obligations incurred by the Bank. It may incur such obligations either by issuing securities in order to make direct loans or by guaranteeing securities issued by other obligors. The great bulk of securities issued or guaranteed by the Bank is likely to be placed with American investors.

In the case of the Bank, no gold contributions from the U.S. are involved. The main effect of its operations upon the System will be the increase in deposits with the Reserve Banks resulting from the Bank's accumulation of dollar working balances. The Bank will need to hold readily available funds against loan commitments on which disbursements have not been completed, against the possibility of sudden urgent calls for loan funds, and perhaps for the purpose of market stabilization operations in securities issued or guaranteed by it. Its normal working balances in dollars may therefore come to equal, or exceed, those held by the Fund, although here too, there is a possibility that non-interest bearing demand notes may be substituted for deposits at the Federal Reserve Banks.

While the sums initially involved will be relatively small, the Bank may acquire dollar working balances of several hundred million dollars during 1946-47, adding a corresponding sum to Reserve Bank deposits and withdrawing the same amount from member bank reserves. In practice, this movement may be found to offset in part the reverse tendency caused by the Treasury's disbursement of funds initially contributed to the Fund (see above).

The portion that is not automatically offset (possibly $500 million) can be neutralized in its effects on member bank reserves by appropriate open-market operations. The net result would be some reduction in the Reserve Banks' portfolio. Meanwhile, despite the rise in their deposits, represented by the dollar working balances of Fund and Bank, the reserve ratio of the Reserve Banks will have been increased by some two percentage points as a result of the initial acquisition of gold certificates.

Indirect Effect Through Influence on International Transactions of the United States

Probably the most fundamental effects on the monetary and credit structure of the United States of the International Fund and Bank will be the indirect effects of their policies and operations on the international transactions of the United States. In the past, monetary and credit conditions have been disturbed by erratic fluctuations in our international transactions and large one-way capital movements. Monetary authorities have also had to meet difficult situations arising from excessive inflows of foreign funds in payment for a continued excess of exports over imports. Both the Fund and the Bank aim to promote international monetary stability by helping to maintain balance in the international transactions of members. To the extent that they succeed in achieving their aims the monetary structure of the United States will not be subject to serious disturbances arising from our international transactions.

Other Possible Relations with Bank

There are a number of ways in which the Reserve Banks might assist the International Bank in its operations in addition to performing the relatively routine agency and depository functions assigned to them by the Bretton Woods Agreements Act. The Reserve Banks, as fiscal agents of the Bank, may be requested to take some part in the distribution of securities issued by the Bank. They may be asked, for example, to receive subscriptions, subject to allotment, from banks, dealers and the general public. As agents of the International Bank the Reserve Banks may also be requested to engage in market stabilization operations for the account of the Bank. The advisability of carrying out such transactions and performing such services must be considered.

The System may also desire to consider more positive measures of support for the International Bank's securities, such as having the Reserve Banks engage in open-market operations for their own account in securities issued or guaranteed by the Bank. Purchases of the Bank's securities by the Reserve Banks for their own account would of course require specific Congressional authorization.

Board of Governors
of the
Federal Reserve System

February 15, 1946