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FEDERAL RESERVE and the BRETTON WOODS PROPOSALS

The Bretton Woods Agreements which are now being considered by the Congress are concerned with the international flow of money. This flow plays directly into the American money market. The Agreements are, therefore, of great importance to the Federal Reserve System which is concerned primarily with our domestic monetary and credit problems. The Reserve System, especially through the Board of Governors, has participated in the development of the Bretton Woods proposals practically from the beginning. Interestingly enough, the history of the agreements thus far is not unlike the history of the Federal Reserve itself.

First of all, both the Bretton Woods Agreements and the Federal Reserve Act arose out of inadequacies of existing institutions to meet pressing monetary and credit problems. The Federal Reserve System grew out of experience with periodic crises and money panics because there was something lacking in our banking system. There was no central banking authority. The Bretton Woods proposals grew out of experience between the First and Second World Wars when it became evident that the gold standard was also subject to crises and breakdowns and that some new system of centralized resources was needed.

The banks in our country before the Federal Reserve Act was enacted were pretty much dependent on their own ability to survive a panic-especially as the panic hit the money centers where reserves from all over the country accumulated through correspondent bank relationships. In a crisis it was each bank for itself. Banks withdrew their funds from one another and, further than that, they began to call loans for payment--adopted a liquidation policy--at the very time when a policy of confidence was needed to weather the economic storm. The Federal Reserve gave such confidence by making credit available to the banks and this power, after the experience of 1929 to 1932, was expanded by the Banking Act of 1935. The Federal Reserve Act is not perfect even now--after many years of experience and many amendments-- but that the System is helpful to our economy, no informed person will deny.

Similarly, under the gold standard each country was pretty much dependent on its own ability to survive periods of difficulties. Individual countries adopted restrictive and deflationary measures in an attempt to weather their own crises. Such measures reduced other countries' sales abroad and spread the difficulties around the world. The Bretton Woods Agreements aim to give confidence to individual countries by making assistance available to meet difficulties when they occur.

Both the Federal Reserve and the Bretton Woods Agreements marked the culmination of years of preparation. Intensive inquiry followed the panic of 1907. Important milestones on the long road were the Pujo Investigation, the work of the National Monetary Commission, and extensive

hearings before the Senate and the House committees on banking and currency--the latter newly organized for the purpose. In addition, there were countless conversations, discussions, conferences, books, pamphlets, and articles. Out of all these emerged the original Federal Reserve Act.

Likewise, the idea of the Bretton Woods Agreements is not recent. This, too, is something developed over the years. More recently, sufficient preliminary work had been done to permit private circulation of a very rough draft of the Fund proposal about three years ago. In April of 1943, a proposal for an International Stabilization Fund was published by the United States Treasury and a proposal for an International Clearing Union was published by the British. Both documents were offered to the public with the hope that all interested parties would contribute to the solution of the problems with which the proposals were concerned. Criticisms and suggestions were reflected in a revised draft of the Fund published in August 1943. November of that year saw the first published version of the plan for an international bank. Conferences, including many with foreign experts and representatives, were held. As a result of the wide area of agreement that was found to exist, a Joint Statement of Experts of many nations was issued in April 1944. Discussions culminated in a preliminary meeting in Atlantic City and finally in the three-week conference of representatives of 44 nations at Bretton Woods in July 1944.

The Federal Reserve System has been intimately associated with the Bretton Woods proposals virtually from the beginning. Experts of the Board's staff have conferred with experts from the Treasury and other Governmental departments and have also participated in discussions with foreign representatives. Technicians of a number of Reserve Banks joined them in the meetings at Atlantic City and Bretton Woods. The Chairman of our Board was a delegate to the Bretton Woods Conference.

The Bretton Woods proposals have repeated the history of the Federal Reserve in another respect. Although there has been all but universal agreement on objectives, there has not been universal agreement on a method of achieving the objectives. Opponents of the Reserve Act in 1913 argued that control should be by bankers, as experienced lenders, rather than by the public, which includes borrowers as well (industry, commerce, and agriculture). It was also argued that the proposed system was too complex to be understood or to be operated efficiently. Similar arguments over control and procedure have been leveled against the Bretton Woods Agreements. It is argued that the Fund is complex and that it will be controlled by borrowers (debtor countries) who will dissipate its resources. I shall come back to this later.

It has also been argued that the directives of the Fund Agreement are too broad and vague to be of much significance. For instance, the term "fundamental disequilibrium" is not precisely defined in the Agreement. But we have learned from our Federal Reserve experience that it is a mistake to make the basic terms of the law too detailed and restrictive. The history of the Federal Reserve Act has reflected the necessity of broadening its terms. It is only under general directives that effective operations and procedures can be evolved to deal with changing conditions. The place for precise definition is in administrative regulations and rulings, not in the basic law.

We should view the Bretton Woods proposals not as a perfect document but as an honest, intelligent, cooperative effort to deal with certain developments that may arise. We should remember also that even our Constitution required subsequent amendments as a result of experience. The same has been true of the Federal Reserve Act. It will be true of the Bretton Woods Agreements. These agreements should be viewed in the spirit expressed by Woodrow Wilson in his first inaugural address:

> "We shall deal with our economic system as it is and as it may be modified, not as it might be if we had a clean sheet of paper to write upon; and step by step we shall make it what it should be."

The Bretton Woods Agreements are an attempt at international collaboration designed to help achieve monetary stability and extension of productive credit. They provide two international institutions to accomplish these objectives: an International Monetary Fund to promote currency stability and multilateral payments and an International Bank for Reconstruction and Development to facilitate productive international loans.

Since the Bank proposal represents no great diviation from traditional lending principles and practices, it is considered comparatively simple and has recieved widespread support and approval. The Bank would make or guarantee at reasonable rates specific loans for productive purposes which the private market would be unwilling to make without a guarantee. Since the benefits of such loans for reconstruction and development would be world-wide, the Bank would distribute any losses among its members in proportion to their stock ownership.

The International Monetary Fund would break new ground and this is the very reason why it is considered complicated. A good bit of the complexity arises from the desire to prevent abuse of this institution which would operate in a new field. The basic principles of the Fund are not difficult to understand. The Fund establishes "rules of the game" which are designed to promote interchangeability among member currencies at stable rates so that the international flow of goods may be kept at a high level. These rules are designed to achieve stability such as once was provided by the gold standard and yet avoid the rigidities that led to periodic collapse of that standard. Each member would undertake to maintain the parity of its currency so long as underlying conditions made it possible but when a fundamental disequilibrium developed the member would be permitted to make an appropriate change. The Fund Agreement recognizes that the undertaking of members to abide by the "rules of the game" would be difficult unless some means were provided to enable them to meet temporary adverse balances in their accounts with other countries. To meet this need, each member would contribute to the Fund an amount of gold and domestic currency equal to its quota and would receive in return a conditional right of access to the Fund for limited amounts of foreign exchange. Although fear has been expressed in some quarters that the resources of the Fund would be dissipated, adequate controls, both automatic and discretionary, are included in the Agreement to prevent unwise use of the Fund's resources.

The Federal Reserve is necessarily interested in both the technical and the policy aspects of the Bretton Woods Agreements. The

technical aspects, though important, need be mentioned only briefly. Both the Fund and the Bank, whose head offices would be in this country, would have a continuous flow of business. They would possess valuable assets such as gold and securities that must be kept safe. There would be a multitude of transactions to be handled and recorded. It is difficult to imagine all the household details connected with the fiscal agency and depositary functions of the Fund and the Bank but they are many and varied and require the special skill of trained and experienced executives. In the United States they would be handled by the Federal Reserve Banks under the supervision and direction of our Board of Governors.

But the Federal Reserve has a much more fundamental interest in the operation of the proposed institutions. Broadly stated, the goal of the Federal Reserve is to help maintain through monetary and credit action a high level of production and employment. The monetary and credit structure of this country, however, is continually affected by international transactions. The Fund and the Bank would work toward a high and stable level of world trade and would therefore help attain our goal.

The disruptive practices that attended the reduction of world trade by about one-half between 1929 and 1934 and the periodic flights of "hot money" in the period between the wars contributed greatly to our difficulties and aggravated the monetary and credit problems of the Federal Reserve System. Through achieving a better international balance, the Fund will help prevent a recurrence of the great gold inflows of the 1930's with their attendant problems for the Federal Reserve System.

Precisely how the Fund's operations will affect our monetary reserves depends on several factors. One of these is the form of the initial subscription.

The effect of the initial subscription depends on the source of the funds. The total subscription quota of the United States amounts to $2,750 million, one-quarter of which must be paid in gold. The enabling legislation now before Congress proposes that ultimately we should pay $1,800 million of the subscription from our Stabilization Fund and the remaining $900 million by Treasury borrowing in the market. At the outset, however, the Fund Agreement permits members to deposit non-interest-bearing demand notes in place of that portion of their currency which is not needed by the Fund in current operations. The initial payment of our subscription, out of the $1,800 million in our Stabilization Fund and by means of the special Treasury notes will not affect our money market, since funds will be neither withdrawn from nor transferred to the market.

If other members use the funds they own here to pay for the gold portion of their subscription, they might affect our market. There would be no effect, of course, if they simply utilized gold held here under earmark since that has already been removed from our gold stock. Use of any deposits they might have at the Federal Reserve Banks would result in a reduction in the gold reserves of the Reserve Banks, but would have no direct effect on our money market. To the extent that they draw funds from our money market, however--either directly through drafts on deposits at commercial banks, or indirectly, as through sales of United States Government securities they own--their gold subscriptions would have the same effect as an export of gold through commercial channels.

Such operations might call for Federal Reserve action in the open market or elsewhere in order to prevent disturbances in the credit situation.

More interesting are the possible effects of the Fund's activities as a going concern. Over the long run, of course, it is hoped that the Fund's holdings of member currencies would maintain relative stability and there are numerous automatic and discretionary controls in the Fund to achieve this result. But there would certainly be substantial use of the Funds's dollars from time to time.

When other members in their current transactions pay the United States with dollars acquired from the Fund, they are likely to increase our money supply. The Fund may acquire the dollars from our initial currency subscription or sales of gold to us, or, to mention a somewhat remote possibility, by borrowing from us. To borrow, however, in this country, the Fund will need our Government's consent.

Use of our initial currency subscription, to the extent that it would be provided from the $1.8 billion in our Stabilization Fund, would increase the supply of money in our market. To the extent that it was provided by the Treasury borrowing from the market, no net effect would be produced since the Fund would, through its members, return the money to the market. Similarly, provision of dollars through the Fund's borrowing in our market would have no net effect. Acquisition of dollars through sales of gold would have the same effect on our money market as an import of gold.

The effects of operations of the International Bank in our money market would be less complicated than those of the Fund and would in general leave the money supply and member bank reserves unaffected. They would, however, influence the capital market and the course of the business cycle. To use American resources the Bank would need to have the consent of this country; and before consent was granted, presumably full consideration would be given by the monetary authorities to the effect of the proposed borrowing on the credit situation in the United States.

This analysis should make clear the great interest of the Federal Reserve in the plans, policies, and operations of the proposed institutions. If the Fund and the Bank achieve their objectives the Federal Reserve authorities will be greatly assisted in their tasks. The Federal Reserve System will not only be deeply concerned with the proper administration and success of the Fund and the Bank but it will be immediately affected in many ways by their technical operations. It must be fully informed with regard to such operations and the Federal Reserve authorities must be in position to present their considered views to the United Stated Governors and Executive Directors of these two institutions in sufficient time.

From our Board's point of view, the establishment of the Fund and the Bank is highly desirable because they would contribute to world recovery and to the maintenance of economic stability at a high level, which is the main objective of our System's policy.