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SOME OPINIONS ON BRETTON WOODS

The Federal Reserve is necessarily interested in both the technical and the policy aspects of the Bretton Woods Agreements. The technical aspects are very important. Both the Fund and the Bank, whose head offices would be in this country, would have a multitude of transactions to be handled and recorded. They would possess valuable assets such as gold and securities that must be kept safe. Their fiscal agency and depositary functions would be many and varied and would require the special and technical 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 would help prevent a recurrence of the great gold inflows of the 1930's with their attendant problems for the Federal Reserve System.

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

The effect of the initial subscription would depend on the source of the funds. The total subscription quota set for the United States is $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. Initial payment of our subscription, either from the $1,800 million in our Stabilization Fund or by the temporary deposit of non-interest-bearing notes, would not affect our money market, since funds would be neither withdrawn from nor transferred to the market.

If other members used funds they owned 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

no direct effect on our money market. To the extent that gold subscriptions by member countries drew 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 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 use of the currency of any member country would not be so extensive as to have temporarily unsettling effects on the domestic money market, and there are numerous automatic and discretionary controls in the Fund to achieve this result. But there would certainly be substantial use of the Fund's dollars from time to time.

When other members in their current transactions paid the United States with dollars acquired from the Fund, the effect would be to increase our money supply. The Fund could acquire the dollars from our initial currency subscription or through sales of gold to us, or to mention a somewhat remote possibility, by borrowing. To borrow here, the Fund would 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 dollars were provided by Treasury borrowing in 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.

Operations of the International Bank would have less complicated effects in our money market than would those of the Fund and in general would 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.

It is clear that the Federal Reserve System would be not only deeply concerned with the proper administration and success of the fund and the Bank but immediately affected in many ways by their technical operations. If these institutions achieved their objectives, the Federal Reserve authorities would be greatly assisted in their task of applying monetary and credit policies that would encourage high production and employment in the United States.

On the other hand, they should render substantial assistance to the attainment of the objectives of the Fund and the Bank in whatever

way consistent and possible. The Reserve authorities should be fully informed with regard to the technical operations of both institutions so as to be in a position at all times to present their considered views to the United States Governors and Executive Directors of these two institutions.

The Board of Governors of the Federal Reserve System favors Congressional ratification of the Bretton Woods proposals, for reasons given in a statement forwarded to the House Banking and Currency Committee on March 21, 1945. In this statement, as indicated by the following excerpt, the Board recommended addition to the enabling legislation now before Congress of provision for a council or committee charged with the responsibility of interpreting American international financial policy to this country's representatives on the Fund and the Bank:

> "In connection with the enabling legislation now before Congress (Bretton Woods Agreements) the Board is strongly in favor of the addition of a provision for the establishment of a council or committee to provide the necessary direction and guidance to the representatives of the United States on the Governing bodies of the Fund and the Bank and to interpret to them the international financial and monetary policies of the United States. Members of this council or committee should consist of the heads of the appropriate agencies of the Government to be designated by the President. It should be a small group, comprising not more than five members. Since the proposed institutions are to be permanent, it would be advisable to have the council provided by law rather than by Executive order or informal arrangement. The Council would not only advise the American governors and directors on the Fund and the Bank of its views with respect to the financial and monetary policies of the United States but would also be authorized to act for the United States in matters which require approval under the agreements, except in cases in which the right to decide will be retained by Congress. Establishment of such a council would assure reasonable continuity in the interpretation of American international financial policy to this country's representatives on the Bank and the Fund. Provision for such a council in the enabling legislation would not call for any change or modification of the Articles of Agreement of the Fund or Bank."

Many specific criticisms have been leveled against the Fund. Other ways of dealing with the problem of international monetary stabilization have been proposed. Alternative suggestions range all the way from reestablishment of the international gold standard as proposed by Kemmerer and Winthrop Aldrich to the recommendation of the Committee for Economic Development which is quite consistent with the Agreements as they stand.

A return to the international gold standard is neither feasible nor desirable. The standard was too rigid. It could be altered only at the cost of a national crisis. The British found this out in the

twenties when they returned to the standard at too high an exchange rate for the pound and as a consequence experienced depression and unemployment in their great exporting industries. Every time a domestic expansion program was undertaken with a view to absorbing the unemployed there was a tendency for British imports to expand and for an adverse balance of payments to develop. The adverse balance put pressure on British gold reserves and in order to remain on the gold standard the domestic program had to be interrupted. The Labor Government was repeatedly frustrated by this situation.

But when England was forced off the gold standard in 1931 it was no longer necessary to retain the pound in its fixed relation to gold. The British discovered they were free to pursue a domestic expansion program year after year and they did it very successfully. England was well on the way to prosperity by the end of the 1930's. This experience has made a deep impression on the British public and, as they look ahead to the uncertainties of the post-war years, the last thing they are prepared to do is to bind themselves irrevocably to a fixed exchange rate under the international gold standard.

Many other countries feel the same way. There is no method by which they can be forced to return to that standard. Nor would it be wise to try to force them to do so. No one can name with confidence at this time a system of exchange rates that would prove permanently appropriate under the shifting conditions of the post-war world. The Monetary Fund, if adopted, would accomplish the utmost that can be achieved in this direction.

Individual members would be bound to maintain stable exchange rates and free convertibility for trade purposes as under the old gold standard; but with the permission of the international group they could depart from this fixed arrangement without a national crisis. That is, if they could make so good a case for exchange adjustment or exchange control that the Fund agrees it would be in the interest of the membership as a whole, action along these lines could be taken. Under the gold standard such action could not be taken even if necessary to correct a fundamental disequilibrium.

Two alternatives to Bretton Woods have been suggested that are consistent with the Fund and Bank Agreements as they stand. The Committee for economic Development has proposed that the Bank be given specific power to make long-term stabilization and general purpose loans. The Committee is afraid that without such a power the temptation to abuse the privilege of drawing on the Fund would be irresistible during the early post-war years. Reconstruction and other needs will be so great during this period that many countries might find it impossible to use the Fund for temporary purposes only. They would fail to replace the strong currencies they had taken out of the common pool and become chronic debtors. These fears of the C.E.D. are understandable; but the fact is that the Fund Agreement already contains a provision which is intended to permit the Bank to make the type of loans the C.E.D. desires. Possibly this provision could be clarified to advantage.

The second alternative suggested would avoid use of the Fund altogether during the transition period. That is the proposal of Murray

Shields, economist of the Irving Trust. He would have this country approve the Fund immediately, along with the Bank, on the understanding that the Fund would not begin business until after the transition from war to relatively stable peace economies had been achieved. Meanwhile he would rely upon relief, reconstruction loans, and other forms of assistance to meet the immediate post-war situation. He would preserve the Fund intact to deal with the more normal problems of the ensuing decades. This could be done without any change in the agreements, since the Fund is under no compulsion to begin operations until it regards the situation as right. The fact that the Fund organization had been set up with adequate resources would meanwhile constitute an assurance to its members that they could safely plan for a multilateral world in the future. The difficulty with Mr. Shields' position, however, is that the immediate post-war problems are likely to be such that all available instrumentalities will have to be used in order to cope with them successfully.

In between the futile longing for the old gold standard and the measures that involve practically no change in the Agreements as they now stand are the proposals of the type made by the American Bankers Association. They are based on the supposition that the members of the Fund have automatic drawing rights which they are sure to abuse. Hence the A.B.A. has proposed that this system of providing assistance be scrapped altogether and that the job of currency stabilization be given to the Bank, which would make funds available only after preliminary investigation and subject to conditions tailored to fit the individual country.

This view misinterprets the very essence and purpose of the Fund. The core of the agreement is that members should know in advance the conditions they must meet to be eligible to use the Fund. Members could proceed with confidence only if assured that they could come to the Fund and receive help in meeting payments for foreign goods and services without delay. Since members could confidently expect assistance from the Fund, they would be able to undertake to maintain stable exchange rates and to eliminate restrictions on foreign exchange transactions. In many cases the fact that assistance would be forthcoming without delay would prevent temporary disturbances from having serious repercussions on the international position of other countries. If a drop in any single country's exports leads to defensive deflationary measures, and restrictions on imports, that country's exchange difficulties will spread to other countries and a vicious circle of restrictions on trade and of deflation will ensue.

To prevent abuse of the privilege of drawing on the Fund's resources a series of specific ontrols have been written into the Agreement. Some of these are automatic. They come into play immediately without requiring a vote of the Fund's management. The Fund could not be drawn upon at all to finance a large or sustained capital outflow. It could be used only to meet a deficit in a country's balance of trade and services. A country that wished to obtain foreign exchange from the Fund to meet a trade deficit would have to pay a service charge of 3/4 of 1 per cent. This charge was deliberately fixed so as to make it cheaper for the country to obtain foreign exchange by using its own gold rather than by drawing on the Fund. It would cost less for a

country to ship gold to the United States and convert it into dollars than to obtain dollars from the Fund. If, however, the country did not have sufficient gold to enable it to do this, or for various reasons wished to conserve its gold stock, and therefore drew upon the Fund, it would not only have to pay the service charge but also a progressive annual charge on the amount of its drawings. This progressive charge would increase, the longer the draft remained outstanding and the larger the amount that was drawn. Increasing pressure would be put upon the country with each passing year or with each additional draft to repay to the Fund the foreign exchange which it had taken out of the common pool. If this check were not sufficient the country would find itself subject to an absolute limitation. It could not draw more than 25 per cent of its quota in any year without the Fund's consent. Finally, there are the so-called repurchase provisions which require any country which has gold or other monetary reserves in excess of its quota to start paying back at the end of the year any foreign exchange it has drawn from the common pool.

Should these automatic controls which require no vote to put them into operation prove insufficient a more powerful set of controls could be brought into play. They are so powerful that they must be left to the discretion of the managers of the Fund. The Fund could postpone the beginning of its exchange operations until it was satisfied that most members were in sufficiently stable condition to warrant use of the Fund's resources. Furthermore, after it had commenced general exchange transactions it could postpone transactions with any individual country which was not in a position to make appropriate use of the Fund's resources. Even after it had commenced transactions with a particular country, it could stop that member from drawing additional amounts if the member was not using the Fund's resources in accordance with the purposes of the Fund. The purposes as stated in the Agreement make it quite clear that the Fund is to be used to help countries meet temporary deficits and to give them time to correct more deep-seated maladjustments. If a country did not take advantage of the time gained by drawing on the Fund to put its house in order and correct its position, the Fund could deny further access to that country.

The different attitudes toward the Bretton Woods Agreements and the reasons given for these attitudes are indicative of the wide interest aroused by the public in the International Monetary and Credit proposals adopted by forty-four nations at Bretton Woods, New Hampshire, in July 1944. The discussions provoked by this interest are healthy and fruitful so long as their purpose is constructive. No informed person can successfully disagree with the purposes of the Fund and the Bank, and as a matter of fact criticism is directed for the most part to the methods suggested for achieving the objectives, especially in the case of the Fund. These methods were adopted after long and serious study and discussion before and during the International Monetary and Financial Conference and many of the objections now being raised were carefully considered before agreement was reached at the Conference. Agreement by forty-four nations on two effective economic instruments is no small achievement in the history of the world and should not be thrown away lightly. To meet the problems facing us after this war, we will need the Fund and the Bank and many other instruments as well to win the kind of peace we have been fighting for.