

Currency Union & Stabilisation Fund

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The outcome of the discussions recorded below, and of the Bretton Woods Conference itself, was the setting up of the International Monetary Fund and the International Bank for Reconstruction and Development, the conditions and rules for whose operation are to be found in White Papers Cmd.6546 (July 1944), 6597 (February 1945) ^{-Supplementary Documents} and 6685 (December 1945).

This is not the place to try to appraise the sufficiency of the scheme for the restoration to health of devastated countries and the maintenance of economic peace in the post-war world. It must suffice to say that the two institutions, with a combined capital of £4,461 mn., five years after the Bretton Woods Conference were in active operation as a vital part of the mechanism of United Nations, faced with problems which seemed at the time of writing (1949) well-nigh insurmountable.

That the Bank were vitally interested in the coming into being of these institutions is no more than a truism. The powers which they might wield over the economy of the U.K. (and other countries) and in particular the possibility that these powers might threaten the sovereignty of H.M. Government to decide on measures to be taken in connection with changes in the values of currencies for which they were directly or indirectly responsible, were of paramount importance. So long as the sterling area existed - and it was contemplated and intended that its existence should continue for an indefinite period - they were committed to a charge whose weight it would be difficult to over-estimate.

The following account of the Bank's views and their participation in the discussions which took place - often recorded at some length - from about two years before the first announcement of the propositions of Lord Keynes and Dr. White to the departure of Lord Keynes and Mr. Thompson-McCausland to take part in the earlier discussions in the U.S.A. (i.e., over a period of about two years, between the autumns of 1941 and 1943) is therefore an essential part of the history of the Bank during the war.

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Before giving an account of the discussions, it will be well to outline the main objects of the two plans and their provisions. These were published in two official papers* which appeared in 1943. Both plans had as a common objective the establishment of an instrument of international currency which ~~should be universally acceptable~~ ^{should be universally acceptable} acceptable. This implied the setting up of a central institution, technical and non-political in character. ~~←~~ The existence and responsibility of such a body, it was believed, should reassure countries who conducted their affairs prudently and relieve them of anxiety from causes not of their own making.

Stabilisation of exchange rates was a primary requisite; and ^{the elimination of} bilateral clearing agreements, multiple currency devices and discriminatory foreign exchange practices - in fact, of as much as possible of the machinery of exchange control (except, perhaps, as regards capital movements) ~~and~~ ^{an} ultimate aim. By these means it was hoped to avoid a ~~long~~ long period of currency demoralisation such as had followed the first World War. It was clear that the authors of both plans had the experiences of the 1920's well in mind and had no intention of risking their repetition.

Both plans

* (1) Proposals for an International Clearing Union
(CNE 6437).
^{u.d.}

(2) United States proposal for a United and Associated Nations' Stabilisation Fund; preliminary draft outlined, reprinted by H.M. Stationery Office.

Both plans were insistent also that the quantum of international currency should not be determined by arbitrary influences, such as technical progress in gold mining, but according to a plan agreed by all members of the international institution to be established.

The Keynes unit was to be called the "bancor"* , whose value in terms of gold was to be fixed by the Governing Board of the Union. The White unit or "unitas" was defined out of hand as consisting of 137½ grains of fine gold, equivalent to 10 dollars U.S. Both units shared the possibilities of a gold standard mechanism, but were of little importance beyond providing a common unit of account. No international unit was, in fact, adopted in the final plan.

Irrespective of the titles or gold standard implications of the proposed international units, both plans postulated the payment to the Union or Fund of initial quotas of gold and local currencies before member States should enjoy the credit facilities of the institution to be. Here the White plan was more specific at the outset, and required 50% of the quota to be paid in before operations began, viz., 12½% in gold, 12½% in members' own currency; 25% in Government securities. The proportion of gold could be lowered ~~to 10%~~ and the proportion of a member's own currency raised by a like amount if the member's gold reserves were less than the equivalent of \$300 mn. ^{The minimum proportion of gold was 5%, where a member's gold reserves was less than \$1,000 million.} The Fund also set a lower limit of \$5 billion on the aggregate of quotas of all members.

The Keynes plan was more concerned with the basis on which quotas were to be allotted, and advocated fixing a quota according to a pre-war three-year average of a member State's total international trade ".....the criterion most relevant to a plan which is chiefly concerned with the regulation of the foreign exchanges and of a country's international trade balance."

The White plan

*credit balances in which could be obtained against gold; but gold could not be demanded against bancor.

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The White plan also agreed that the formula should give due weight to ^{such} important factors ~~as~~ as the magnitude of fluctuations in a country's international balance of payments and ~~national~~ ^{national} income.

There were in both plans arrangements for the purchase (under certain conditions) of abnormal balances resulting from war expenditure in other countries.

Attention is here drawn to the general similarity (pointed out to the press in Washington by British officials) in the nature and purposes of the two plans rather than to the many differences to be found in their presentation, to which much comment was at first directed. However, these differences must not be overlooked, notwithstanding possible differences of interpretation. There were, on the one hand, strong adherents to the gold standard who would have nothing short of a return to its full working, and on the other, those who objected to either plan on the grounds that it provided a link between national currencies and gold.

Each of the plans laid stress on certain provisions of its own, of which the following were important:-

The Keynes (Clearing Union) plan offered initial membership to all United Nations; other states might join later, ex-enemies on special terms.

The White (Stabilisation Fund) plan did not specify, but presumably intended universal membership.

The Union's basic principle was, as its title implied, that of clearing debts and credits....."to generalise the essential principle of banking as it is exhibited within any closed system." The central banks of all member States would be entitled to exchange the equivalents (in bancor) of their balances through the Clearing Union.

The fact that some States would have debit balances (the result of debtor trade positions) brings out another fundamental difference between two plans; because the "overdraft" principle in British banking was not admissible to the White plan. The Stabilisation Fund was to sell (against gold or unitas) currency of member countries required by other member countries to discharge their debts to members.

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Both plans, however, agreed that growing disequilibrium in either direction demanded either the permission of or consultation with the Governing Body (of either Union or Fund) before a member State either in default or with a substantial credit position adjustedⁱ by resort to currency revaluation in terms of gold, bancor or unitas. If a member's debit balance had exceeded its quota on an average of at least two years, the Keynes plan allowed devaluation (on one occasion only) by 5% without the Governing Board's consent.

Discussions between

~~of about two years, between the autumn of 1941 and 1943) is therefore
an essential part of the history of the Bank during the war.~~

Discussions between the Treasury and the Bank on post-war financial, monetary and trade policy began in September 1941 and included the Keynes proposals for an International Currency Union (sometimes called the Clearing Union), the first draft of which was dated 9th August 1941. This in turn had a close relationship to a paper on "The Nineteen-Thirties" by Sir Hubert Henderson*, who was acting as an Adviser to the Treasury. It was a plea for a system which would provide scope for national policies of planning and control, including exchange control, quantitative regulation and bilateral trade agreements. In it he pointed out certain weaknesses of the gold standard, in that a country's domestic policy was placed at the mercy of the vagaries of international speculators and that deflation "involved the paradox of a large waste, through unemployment, of productive power in a country whose difficulties might arise from already being poor." In a memorandum covering his sketch for a Currency Union, Lord Keynes amplified this point. A given loss of gold by such a country, if it is in economic importance, say, one-fifth of the world as a whole "will probably exercise four times as much pressure at home as abroad, with a still greater disparity if it is only a tenth or a twentieth of the world, so that the contribution in terms of the resulting social strains which the debtor has to make to the restoration of equilibrium by changing its prices and wages is altogether out of proportion to the contribution asked of its creditors." Again, the social strain of an adjustment downwards is

*Mr. H. D. Henderson, created a.k. in 1942.

much greater than that of an adjustment upwards and is compulsory for the debtor and only optional for the creditor. Further, the adjustments open to a debtor country are liable to have an adverse effect on its trade, since a reduction in international prices of exports in terms of imports may not stimulate exports sufficiently if demand is not equally elastic. His conclusion was that any new system must "require the chief initiative from the creditor countries" while maintaining a sufficient discipline in the debtor countries. The Currency Union plan was therefore designed to place responsibility on creditor as well as on debtor countries and was further intended to be of an "expansionist" nature in order to avoid the difficulties of deflation as much as possible.

The plan was regarded as only one part of an attempt to define the Treasury's position for Anglo-American discussions, nor was it certain at first whether it was to be accepted as an essential part. For some time it was other (though related) aspects of policy which chiefly engaged the Bank's (and the Treasury's) attention - capital movements, export and import policy, the sterling area, etc. Some internal memoranda of personal views on the Keynes plan were, however, written by four or five of the Bank's chief officials. None of these was exactly favourable to it, and some were distinctly adverse. Some other personal memoranda were sent to Lord Keynes informally on the 24th November but these were rather indirectly concerned with the Currency Union, the scheme being regarded as "tactical rather than practical" at that stage.

On tactics the Bank favoured an avoidance of any attempt to introduce into the immediate post-war foreground a picture of what might eventually be realised. To do so might suggest that there was a perfect arrangement which could be attained without much effort.

A fresh draft was received at the end of November, with a request for the Bank's views, and a further revision (3rd draft) in mid-December, and on the 30th Mr. Cobbold wrote to Lord Keynes as follows:-

"Thank you for your letter of the 17th December sending me the latest revision of your international bank proposals. I do not propose to go over the whole ground again at this stage: you are, I think, familiar with my doubts about certain aspects of the scheme as a whole and we shall doubtless have opportunities of discussing the whole subject further in due course.

I should, however, like to say a word in the meanwhile on one of the points to which you draw my particular attention, i.e., the new passage on the sterling area. I believe that your paragraph as expressed might be read as suggesting that the sterling Dominions, India, etc. should be encouraged to hold their reserves in the international currency unit rather than in sterling and to clear direct through the international bank rather than through the intermediary of sterling.

I agree, of course, that, if we are to maintain the confidence of the sterling area in sterling, we must do our utmost to make sterling utilisable over the widest possible field and offer the highest possible degree of convertibility of sterling into other useful currencies. But by whatever means this is achieved, whether by the gradual amalgamation of bilateral agreements into multilateral shape, or by the sudden formation of an international currency union, we should still wish the sterling area to bank and clear in London in sterling and regard sterling as their link with other currencies (including, if there be such, an international currency unit).

Once the area starts to hold its reserves in another currency or even in an international currency unit and to clear direct through another centre or through an international institution, it will inevitably cease to think in terms of sterling and will drift away from London. If and when any international currency system comes to be adopted, we ought, in my view, to encourage the sterling area to continue to look to sterling and London as its link with other currencies, and we should concentrate on making sterling a useful and desirable currency: i.e., the whole of the sterling area's transactions with an international currency union should pass through the intermediary of sterling and London.

If, as I think may be the case, you agree with these views, you might think it worth while to amend the paragraph in question so as to avoid the risk of what I think would be a dangerous interpretation."

Here it may be said that an inadequate appreciation of the nature of the sterling area and the bearing upon its problems of the Keynes plan, and still more of the American plan (White's Stabilisation Fund), proved to be one of the chief difficulties with which the Bank had to deal.

Lord Keynes replied (2.1.42) that he was in general agreement with the Bank, and a fourth draft arrived at the end of January 1942, ^{amended as regards the} ~~sterling~~ sterling area. The new draft provided that the area should be linked both to London and to the proposed Clearing Bank of the Currency Union. The Bank of England were not quite satisfied, thinking this compromise "must tend to weaken the

solidarity of the sterling area both in theory and in practice" (L. 2.2.42). The rejoinder was that "the freer we are able to leave the other members of the sterling area the more willing they will be in practice to continue their existing habits without modification".

Meanwhile discussions on general trade policy had been actively pursued, and a long memorandum had been drafted in the Treasury as the basis for discussion with the Americans. It included the Keynes Currency or Clearing Union plan, with observations by the Treasury on its advantages and disadvantages.* The Bank's comments on this part (Dpy.Gov. L. 6.2.42) were:-

".....

Our principal doubt about the proposals for a Clearing Union has always been that they might too easily come to be regarded as a solution for all evils, removing the need for the underlying measures referred to above on capital and current account. We still feel that this danger should be underlined, although we are in general agreement with your critical survey of the Clearing Union proposals and with your conclusion that the proposals might usefully be put forward in general form, but not dogmatically, as a target for discussion and as a possible contribution to a new monetary mechanism. We continue to consider the Clearing Union proposals in this general light and have refrained from criticism of detail, which appears to us premature.

....."

No further references to the Clearing Union proposals, except the expression of a hope that another scheme of Lord Keynes, for holding buffer stocks of primary commodities, would not be associated with it, is to be found until August, when another revision of the scheme was sent to the Bank. This was said to be in a form in which it could be handed to the Americans and to the Dominions. In October and November H.M. Government held a number of meetings on post-war economic and financial problems with the Dominions and India, and at some of these meetings various amendments to the Keynes plan were suggested, mostly of a not important

character

*This memorandum was not used at the time for negotiating with the U.S.A. but was only circulated internally to British Government Departments, and resulted in Ministers giving general approval to the International Currency Plan.

character. After these discussions a copy of the plan was given informally to the U.S. Treasury.

1943

The plan for a "Stabilisation Fund of the United and Associated Nations" (White Plan) was forwarded to Sir F. Phillips, the British Treasury's representative in Washington, on 1st February 1943 by Mr. A.A. Berle of the State Department. A long paper embodying a draft had been handed to Lord Keynes some time previously and must have been seen by ^{Sir Frederick} Phillips as he commented that it was "substantially White's document stripped to the bare bones of Articles of Association".

Questions as to subsequent procedure to be adopted on both plans occupied some months. But the U.S. Treasury at once gave copies of the White Plan to Russia and China. The Bank began to analyse the Plan and sent some preliminary observations and questions to the Treasury on 18th February.

"I thought that you might care to see a copy of an internal memorandum resulting from first thoughts here about the Berle [White] Plan. It does not seek to deal with any of the wider issues involved (e.g. composition of Board, abrogation of national sovereignty, sanctions, basis of quota, etc.) nor have we had time to clear our minds about the "blocked balances" proposals. We have made no attempt to weigh the pros and cons of the Plan.

"We find it impossible to make up our minds about the Berle Memorandum from a technical point of view without some further elucidation. In general, we read the scheme as a combination of Tripartite Agreement with American Stabilisation Fund principles. If that is correct it would appear to be incompatible with Exchange Control on the British or continental model, where there is only one eventual holder and source of exchange and consequently no exchange market in which a Stabilisation Fund can intervene. The only innovations, as compared with the pre-war period, appear to be the provisions

for

for controlling capital movements, apparently by "freezing" machinery, and for liquidating blocked balances.

"Before the Plan can usefully be examined further information is necessary about what is in the minds of the sponsors of the plan. A note is attached of some of the questions which need answers, although not all of them may be suitable for putting to Washington. The Plan for dealing with blocked balances requires, in particular, much elucidation: the attached questions do not go into this point.

"A further note is attached setting out some of the points at which the Plan appears to differ from the Clearing Union."

On the same day a Treasury criticism was issued for the benefit of their Washington representatives and was also sent to the Dominions. It pointed out that the White Plan was not expansionist, was somewhat obscure and sometimes inconsistent and that it did not handle well the liabilities of creditors. The treatment of "blocked balances" (or "abnormal war balances" - the description ^{which} the Treasury tried to have substituted) was, however, described as very liberal (and helpful to Great Britain) - a point of view not accepted by the Bank, as appears later.

On 26th February the Clearing Union scheme was consequently distributed and explained to a meeting in London of Finance Ministers and others representing 16 countries (including U.S.A.), after which it was thought that the existence of the two plans could not successfully be kept secret much longer. Both the American and British authorities prepared drafts of a covering document, in which the Bank took a hand though they would have preferred to see no publication at this stage. They were becoming agitated about the proposals for "blocked balances" in the White Plan and wrote to the Treasury on 2nd March -

"With reference to my letter of the 18th February about the Berle Plan, I now write to put forward certain points which occur to us about the proposals for dealing with "blocked balances".

"We still have no clear idea about what balances the Americans

have

have in mind nor do Phillips' latest telegrams help but I understand that no doubt is felt in the Treasury (particularly in the light of earlier conversations with Harry White) that the Americans mean to include sterling balances owned by India, Egypt and other parts of the sterling area, which we do not of course regard as blocked.

"In the first place do you feel that the funding, by an International Fund, of all or a large proportion of sterling balances held by members of the sterling area is consistent with maintaining the sterling area conception? Or perhaps it may be that the Stabilisation Fund as a whole is inconsistent with sterling area ideas and that it would come to mean each Dominion etc. dealing direct with the Fund, keeping its exchange reserves in dollars rather than in sterling and by-passing London for its international transactions. That is surely a direction in which we ought to be slow to move.

"But even admitting the doubtful possibility that the sterling area's sterling balances could thus be funded without general prejudice to the working of the sterling area there are several points which need consideration -

1. Does not a solution, or the promise of a solution, on these lines rule out any hope of an equitable settlement with India and others on "equal sacrifice" lines? If there is a ready formula at hand to deal with excessive balances nobody will listen to a more radical solution.

2. Even if we made no headway on equal sacrifice lines are we any better off if our liability, instead of being spread about in various sterling area hands, is concentrated in one hand dominated by the Americans? Provided that, as we surely must, we refuse to allow India etc. to change their sterling reserves into gold or other currencies, they can only use them to the extent of their adverse balance of payments. Thus even in the absence of a direct and formal funding arrangement with India etc. the balances can only be used gradually and their transfer into dollars would only represent a flight of capital.

3. Are

3. Are we in any position to take on an annual liability in gold or foreign exchange which, if the balances to be funded were by the end of the war to amount to £1,000 million, would be £30-40 million per annum for the United Kingdom and double that figure on the sterling area reserves as a whole?

4. Would not the proposed funding arrangement remove incentives for India etc. to trade with the United Kingdom?

5. What would happen if the Stabilisation Fund were liquidated during the currency of the funding arrangement, leaving the Americans as presumably the principal creditors?

In short, is not the likely effect of the proposal to convert the sterling area's war time balances into an onerous war debt on a dollar basis, with the United States directly or indirectly the principal creditor? I suggest that this is not a position into which we want to slip and that we ought to clear our minds about these American ideas before they go too far."

On 13th March the Treasury informed Washington that the fact that the Clearing Union paper had been distributed to European Allies had leaked out, with some newspaper publicity, and that official publication of both plans should be considered. Two days later the Chancellor announced the Government's intention to publish the British Plan shortly. The Bank prepared the replies to be given by them to all inquiries from the public and press, and agreed them with the Treasury.

Telegrams criticising and endeavouring to elucidate the White Plan had been passing almost daily between London and Washington, and the Bank had evidently been consulted by the Treasury on their communications for, on 29th March, the Bank wrote -

"We find it difficult to see how the new mechanism could be launched convincingly and confidence established in "bancor" if the Americans used "free market" and "stabilisation fund" procedure and if the Clearing Union were not used until an "unbalanced position is developing" (cf. para.26 of Clearing Union proposals). If bancor is to have such a limited function

then

then the "banking principle" which you regard in paragraph 3 of draft as fundamental to the scheme (rightly we think) seems to be prejudiced.

"But we confess to finding it increasingly difficult to comment on this telegraphic exchange of views and we fear that it will prove difficult to elucidate obscure points by this method. In particular we do not see on what basis a "reasonable" quota can now be suggested."

The Americans had been in two minds about publishing but a leakage of the White Plan in the U.S.A. decided them, and both plans were published on April 7th.

Discussions on procedure and on the possible "conflation" of the two plans continued, but the Bank appear to have withdrawn from any active intervention, though they saw all telegrams and documents, until the middle of June. Canadian proposals for an International Exchange Union attempting a compromise between Keynes and White, but based more on the latter's scheme, were drawn up under date of 9th June but were not at once published. They were sent to H.M. Treasury on 3rd June. A revised draft of the White Plan was issued confidentially on 15th June.

Meanwhile a Treasury telegram to Washington of 12th June had incurred the Bank's disapproval, especially a paragraph indicating that the "banking principle" (Keynes Plan), hitherto regarded as fundamental, might be abandoned in favour of the "subscription principle" (White Plan). The Bank felt that the Treasury had been "outmanoeuvred" and would, if not careful, "find themselves more than half committed to the Stabilisation Fund schemes". The Governor accordingly warned the Chancellor on 17th June.

A meeting with representatives of about 17 countries had taken place in Washington the day before to discuss the new version of the Fund, and it was apparent that the Americans had made a few concessions to the British. A memorandum by Mr. Cobbold (18th June) indicates the Bank's views at this time; it was passed on to the Treasury -

"Washington

"Washington telegram No.76 Remac does nothing to dispel my anxieties about the way things are moving. Willingness on the part of the American Treasury to make concessions about the size of the fund and rigidity of gold price and exchange rates only increases the danger of some commitment by us to the fundamental idea of S.F.

"I doubt whether even now the essential difference between C.U. and S.F. is fully appreciated in Whitehall. Under C.U. (with the "banking principle") the central body is inevitably passive because it has no funds of its own and must wait for an initiative from one of the member central banks. Under S.F., although we have not been able to elucidate whether the intention is for the central fund to be active or passive, it will have large funds of its own and we can be pretty sure that in fact it will be extremely active. The fund would doubtless deal heavily in exchange for its own account and would be likely at one time or another to hold such quantities of sterling and other Empire currencies as would completely dominate the position. If we get tied up to S.F. plans we can say good-bye to any ideas of control over our own exchange position, of the volume of sterling available for investment overseas and of sterling interest rates (it is specifically laid down in S.F. that currencies held by the fund shall be free from any restriction as to their use).

"Phillips showed in 1320 of the 20th March that he had got the point but I do not know whether he has drawn all the conclusions."

The question of Abnormal War Balances was raised again in a memorandum (19th June) by Sir David Waley -

"Objections to the S.F. proposals are outlined in Cobbold's letter of the 2nd March and in my note of the 28th April. Cobbold's objections were -

- (1) The scheme is inconsistent with maintaining the sterling area conception.
- (2) It rules out an equitable settlement with India on equal sacrifice lines.

(3) These

(3) These sterling balances do not constitute an automatic or inevitable gold liability and it would be a mistake to fund them in a way which will impose an annual gold liability upon us. If S.F. were limited this annual liability might be converted into a lump sum liability.

"In short, is not the likely effect of the proposal to convert the sterling area's war time balances into an onerous war debt on a dollar basis?

"My objection was that I read S.F. to mean that India would have the right to sell the whole of her sterling balances to S.F. and to ask for rupees, and I did not see how S.F. could obtain rupees except by crediting the Reserve Bank of India with sterling, which would leave us just where we started.

"Lord Keynes makes S.F. intelligible by reading it to mean that India could only sell sterling balances insofar as she wants to reduce the amount of rupees already held by S.F. or to obtain dollars etc. to meet a deficit on current account. It would be better still if India could only sell sterling balances when she has exhausted her normal quota, so that in effect India would receive an additional quota, but we should have the liability to pay off 40% of the additional quota at the rate of 2% for 20 years. On this interpretation I agree that the S.F. proposal would be on the whole advantageous to us. It would really mean an increase in India's quota of some £90 millions with no very onerous obligation on our part.

"Dr. Coombs* told me that he had discussed with Mr. White how the sterling area conception would fit into S.F. They apparently agreed that Australia might continue to keep her balances in London. If she ran short of sterling she could use part of her quota to obtain sterling from S.F. If she had a net need for dollars on current account, Australia would have the option of getting the dollars from S.F. in return for Australian pounds within the limits of her quota. No doubt we should want to qualify this by saying that if we were short of dollars we should not be prepared to let Australia have any considerable amount

*An Australian representative.

amount of dollars and she would have to obtain them direct from S.F. against Australian pounds. If this kind of system were applied to India or Egypt it would no doubt be helpful for India and Egypt to have additions to their normal quotas under the abnormal balances scheme."

On this Mr.Cobbold made the following note -

"I had a long discussion yesterday evening with Sir David Waley on his letter of the 19th June about S.F. and abnormal war balances.

"I confirmed the doubts expressed in my letter of the 2nd March. I also expressed the view that these proposals arise from the misconception that the balances were really blocked whereas in fact they were freely available for expenditure over a large area. To regard an option to convert them into another currency as an additional "quota" for the country owning the balances seemed to us a misconception. Moreover, as far as we understood the proposals it would seem that the effect would be to give, e.g. India, a further claim on dollars in diminution of the U.K.'s dollar resources.

"I suggested in particular that it was impossible to foresee the effect of the proposals relating to abnormal war balances whilst we were still so hazy about the effect of S.F. in general, particularly in regard to the sterling area. It seemed to me a tactical mistake to express approval at this stage of a particular and obscure section of the proposals.

"Waley said that he would suggest a temporising telegram leaving the matter for exploration with Phillips when he is here next month."

Lord Keynes also contributed (22nd June) a memorandum on this subject, still warmly welcoming the White Plan proposals, to which Mr.Cobbold replied (25th June) -

"Thank you for your letter of the 22nd June enclosing a revised note about abnormal war balances. I feel sure that it would be wise not to express approval of this particular part of the S.F. Plan until we see more clearly how S.F. would react on our position and on the general sterling area set up. I am glad

to see

to see that a telegram has gone to Washington suggesting that we should first discuss with Phillips."

On 2nd July the Bank once more began to take the initiative with the Treasury when Mr.Cobbold handed them a memorandum of which the following were the conclusions - S.F. seems likely to

- (a) Reduce U.K.'s external reserves to a negligible quantity from the outset and keep them down to that level;
- (b) Take out of U.K.'s hands the initiative in and control of their own currency and exchange policy;
- (c) Expose the U.K. to a continuous threat of a new "1931", with the difference that foreign sterling holdings will be largely concentrated in the hands of one owner, who will have no natural use for, or traditional link with, sterling;
- (d) Force the U.K. to apply defensive exchange control more rigidly and universally than during the war;
- (e) Transfer from London to an international body the dominant voice in imperial currency and exchange policy;
- (f) Break up the existing arrangements for payments and credit transactions both between different parts of the Empire and between the Empire and the rest of the world;
- (g) Drive sterling out of international use, destroying London's international financial and merchanting business.

It is not clear what compensating advantages the machinery of S.F. gives to the U.K.

It may be argued that the S.F. would be so wisely and long-sightedly administered, without regard to "profit and loss" and "gold" considerations, that none of these things would in fact happen. But in the knowledge the S.F. is built on the basis of free exchange markets and is gold- and dollar-minded from the outset could we afford to take the risk?

The issue is not merely one of choosing between two pieces of technical machinery: but leads straight to decisions of policy of the first importance both to this country and the Empire as a whole.

Much of the doctrine enshrined in the S.F. proposals

(avoidance

(avoidance of competitive depreciation, control of capital movements, etc.) is not in question. Much of it is the same as is propounded in the C.U. proposals and is to the interest both of the U.K. and the world in general: but the S.F. machinery is in no way essential to these objects. Is it not urgently necessary to lead the discussions away from machinery and to concentrate on doctrine?"

A copy of the Canadian proposal for an "International Exchange Union" had been sent to the Governor by the Governor of the Bank of Canada (Mr. Towers) and Mr. Norman's reply (8th July) also indicates his distrust of schemes the discussion of which had been confined too much to methods of operation and too little to fundamentals -

"I am sure you will allow me, in writing to you thus personally, to be frank and to say that there are several features in these proposals which I quite dislike and fear. We here are bound to look at all such plans not only from the standpoint of the world as a whole but also from that of the British Empire and this country. It is my firm belief that any international institution thinking primarily in terms of gold and U.S. dollars, but dealing in and holding large quantities of sterling and local British Empire currencies, can only lead to trouble. Times have changed and things have moved forward and I do not believe that a technique of unrestricted exchange arbitrage can be fused in one mechanism with the (to my mind more modern) technique of controlled and directed exchange policy.

"There is a superficial appearance of common agreement between the authors of the various proposals but oral discussions have been restricted to "methods", to the exclusion of policy and objectives. Is it not unwise to assume that international agreement on "methods" of organising the foreign exchanges will lead to positive results, if there are any doubts, as I believe there to be, about policy? If I may quote from your enclosed observations, are you certain that "unregulated movements of capital between countries will be prevented"? - a policy which

cannot

cannot be carried out by statistical or "freezing" checks but which will demand continuous supervision and control in peace time over the affairs of citizens.

"For my part, whilst applauding much in these proposals and setting an international organisation as the distant goal, I should prefer to be less ambitious and to start some way nearer the ground. I think it is possible here and in Canada and the relations which have sprung up during the war between the Canadian dollar and sterling point a way along which, by development and adjustment to meet the rebirth of international business, much could be practically achieved."

Some replies from the American Treasury had been received to questions on the White Plan and were read by the Bank. They are not filed at the Bank of England but "confirmed our worst fears" (Mr.Cobbold, letter 9th February 1943).

Sir F.Phillips and other British Treasury Washington representatives were now in England, among them Mr.Opie. Mr.Cobbold wrote -

"I had a long talk to Mr.Opie yesterday, mainly about S.F. and C.U. and touching later on reciprocal aid and gold and dollar balances.

"The conversation left me more than ever confirmed in the view that there is no possible compromise between S.F. and C.U. which could be acceptable to us. Opie confirms absolutely that S.F. is built on a free market conception and is intended to pave the way back as quickly as possible to a full gold standard with all currencies convertible into gold. He agrees that any currency not convertible into gold would always be regarded with disfavour by S.F. He also confirms that the authors of S.F. only admit control of capital movements as a temporary and objectionable device pending restoration at an early date of complete convertibility. Opie still seemed to be flirting with the idea of reaching a compromise text though he seemed to hope that it might deal mainly with principles, leaving machinery to a rather later stage. I did my best to shake him about any machinery which involves an international organisation holding and dealing in currencies."

* "The revision shows no increase in political wisdom and not much in technical capacity. Some of its provisions are drafted with gross selfishness in the interests of a country possessing unlimited gold." *

"Fortunately.....changes are not forbidden by any of Dr.White's 'essential conditions'."

- (i) The Subscription Principle;
 - (ii) Limitation of Liability;
 - (iii) No country should be required to change the gold value of its currency against its will;
- and also the U.S. formula for quotas, voting powers and an initial exchange rate of £1=\$4.

Our own essential conditions should be:-

- (i) Drastic revision of the provisions for retaining sovereignty in respect of changing the value of a member's currency;
- (ii) No dealing ~~is~~ in a "mixed bag" of currencies not redeemable in gold;
- (iii) Acceptance of the original S.F. proposal for a gold subscription of $12\frac{1}{2}\%$ of a member's quota, or its modification in such a way as not to give the scheme too pronounced a gold-standard appearance;
- (iv) Provision against the disturbance of general equilibrium by a persistently unbalanced position (after taking account of any offsetting capital movements) of a country which is a net creditor on current account.

Entirely unacceptable features were:-

- (i) The rigid tying of sterling to gold, except in the first three years, during which the currency was allowed a ten per cent change.
- (ii) The free exercise of the Fund's discretion in buying and selling currencies "required to meet an adverse balance of payments predominantly on current account" and its consequent rationing of scarce currencies. This cut right across the U.K. 2nd essential condition (above).

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On 19th July Lord Keynes circulated a memorandum on the latest version of the White Plan, containing very adverse comments.*

We had now to reply to Dr. White, and to state what we, on our side, regarded as essential. Lord Keynes recommended our acceptance of the White essentials, viz:-

- (i) The Subscription Principle;
 - (ii) Limitation of Liability;
 - (iii) No country should be required to change the gold value of its currency against its will;
- and also the U.S. formula for quotas, voting powers and an initial exchange rate of £1=\$4.

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- (ii) The free exercise of the Fund's discretion in buying and selling currencies "required to meet an adverse balance of payments predominantly on current account" and its consequent rationing of scarce currencies. This cut right across the U.K. 2nd essential condition (above).

(iii) The much larger gold subscription now required (which made our third condition necessary)....."It is not clear" (in particular *the* amounts to be handed over to the Fund at the end of the war)"what this gold is to be used for."...."It is entirely unreasonable that, with our huge liabilities and responsibilities, we should hand over this high proportion of our total reserves to an untried institution."

The Bank commented (26th July) to the Treasury:-

"Subject to one or two points, I agree with Lord Keynes' note on Stabilisation Fund of the 19th July

Paragraph 3: Although we may in our own minds accept White's "essential conditions" (provided that he accepts ours), I suggest that it is a mistake to tell him so at this stage..... In particular it would be necessary to make it abundantly clear that we can only accept the subscription principle if the resulting funds are locked up and cannot be used as a basis for dealing in currencies. But is it not much wiser to limit ourselves to setting out our own essential conditions, which is what White has asked for? To accept his at the same time as putting forward ours seems to me bad tactics and dangerous. I should in any case not mention at this stage an exchange rate between the pound and the dollar; we may agree in our own minds that the initial rate will be £1=~~3~~4 but I see no advantage and great tactical disadvantage in giving this away to the Americans at this stage.....

I agree with Lord Keynes that it is urgent to communicate to the U.S.Treasury our own essential conditions (though not, I suggest, our acceptance of the American essential conditions).

But I suggest that the time may be ripe to follow up this reply by a somewhat new approach rather than give White time to prepare and circulate a new draft. This might prove preferable to waiting until the delegation gets out there before making a counter proposal. From what we know of American detailed ideas about mechanism it seems unlikely that an agreed scheme of mechanism can be reached except after long and perhaps acrimonious argument. Nor do I believe that from the present state of negotiations any mechanism can emerge which will carry the whole-hearted support and approval of the business and general public here and in America.

The important thing is surely to take advantage of the fact that the United Nations are at present engaged on a common enterprise to agree on certain general principles, first as between the British Empire and the U.S.A. and next so far as possible between the United Nations as a whole. If agreement could be reached on general principles an international institution with brief and easily intelligible terms of reference, and including long-term as well as short-term international lending under its wing, might prove helpful in carrying out those principles. Such an institution might hope gradually to acquire sufficient authority and standing with Governments and with the public to make its voice heard in the formation of national policy and to introduce new mechanism if that were found necessary; whilst leaving the responsibility for formation of their own national policy and the management of their own currency on the shoulders of each national Government.

I suggest that the next step should be for a new approach on these lines to be considered."

A discussion on Lord Keynes' note took place at the Treasury on 28th July, attended by Mr. Cobbold as well as by representatives of the War Cabinet, Board of Trade and Dominions Office. The present position was explained and there followed an examination in particular of points on which there existed official British views which did not coincide with American. Among these

were the desirability of merely establishing general principles rather than incurring the risk of alarming Parliament and Public opinion by what appeared to be very wide powers over the economies of member States. It was the general view of the meeting that our aim should be the setting up of an institution whose outline, however, should be drawn firmly and not in full detail. In short, we would only accept such an institution if its functions and procedure satisfied certain conditions of our own.

Agreement was reached on various points, viz:-

Limitation of Liability - accepted, provided it did not prevent the creation of a total fund reasonably adequate in amount.

Gold Value of the Dollar. Some drafting would be necessary to reassure the Americans.

Subscription Principle. If it were urgent that the Americans could not meet us on this point we should not oppose the banking overdraft as against the Subscription Principle.

Nature and Purpose of Subscription. The British delegation would have to be firm in securing, as a condition of an agreement, that the Fund should not deal in currencies but only in transferable Units.

Exchange Stability. We should endorse the principle of stable exchange rates; and could accept a reasonable, agreed procedure for dealing ~~with~~ provided Dr. White's most recently contemplated proposals for latitude formed part of it. (The latest draft of the S.F., however, did not provide ^{adequately} for ~~adequately~~ reasonable pressure on a creditor country to make the principle work.)

On procedure it was agreed:-

- (a) That we should enter into bilateral talks with the United States on the lines of the discussion at the Meeting.
- (b) That the Drafting Committee should aim at producing a draft incorporating the main principles and giving a firm outline, but should avoid attempting to introduce all the detail in the latest version of the S.F. scheme. It was probably inevitable that the Drafting Committee should

deal with the question of voting rights; but, as far as practicable, that also should be governed by a statement of principles.

- (c) That a paper should be prepared for interested Ministers explaining the position briefly and giving a draft directive for the delegation on the lines of the discussion at the meeting.
- (d) That unless some event occurred which made direct contact desirable no overtures should be made to the American Treasury until the delegation arrived in Washington; but that Mr. Opie on his return to Washington should, if a favourable opportunity presented itself, mention the points which were giving us difficulty and, in relation to the subscription principle, should use the line of argument in the note he had prepared.

Mr. Cobbold was not altogether in agreement with the conclusions reached, and wrote to the Treasury on 9th August 1943.....

"For purposes of record I should like to confirm that you were good enough to invite me to this meeting on the understanding that you preferred me not to raise on that occasion certain rather fundamental points and that in consequence you would not regard the Bank as committed to any conclusions reached in the meeting.

I should like in particular to reserve the Bank's position on two points. First, as you are aware, we tend to the view set out in the first paragraph of Section 2 of the note, viz., that there is a lot to be said for an agreement on principles before attempting any agreement on mechanism or procedure and that the creation of an institution might wisely be left to a second stage.

Secondly, I should have thought that the conclusion in the last paragraph of Section 5 of the note goes further than the general views expressed in the meeting which were, I should have thought, more on the following line -

'It was agreed that we should endorse the principle of stability of exchange rates as one of the first aims of policy, but that any agreement limiting national sovereignty in this respect was likely to raise difficulties. It was felt that \$4 to the £1 might in due course be accepted as the initial rate but that there was no advantage in committing ourselves on this point until a later stage.....'

If you prefer to retain the original minute I should like specifically to reserve the Bank's position on this point as well. You will remember that I expressed the view that provisions for consultation with an international board about changes in exchange rates are in practice meaningless as no

Government could afford to make its intentions so widely known in advance: this view was I thought generally accepted by those present at the meeting.

On a rather less fundamental point, I should like to record the doubts which I expressed about the suggestion in paragraph 3 of Section 4 about a general guarantee of the securities forming part of the subscription."

On the same day he wrote again suggesting a new form of approach to Washington:-

"I mentioned to you the other day the possibility of a rather new approach to currency discussions with Washington and you asked me to let you have our more considered views.

Our general feeling is that the whole subject is in danger of being submerged in a mass of complicated technical and mechanical detail, a great deal of which is highly controversial and most of which is entirely incomprehensible to the general public. This view is strongly reinforced by the the latest drafts of S.F. and by the long memorandum of answers to questions sent over by the U.S.Treasury. From what we know of American detailed ideas it seems unlikely that an agreed scheme of technical mechanism can be reached except after long and perhaps acrimonious argument. If H.M.G. once get involved in argument about mechanism they obviously run the risk of being forced for political reasons into mechanical arrangements of which they do not really approve: the alternatives of accepting proposals which do not really enjoy H.M.G.'s support and of having an open dispute with the American Government are both unattractive.

Moreover, it is surely unwise to seek to impose on public opinion detailed mechanism which does not inspire general confidence. We do not believe that from the present state of negotiations any technical mechanism can emerge which will carry the wholehearted support and approval of the business and general public here and in America.

I understood from you that the present intention is to open more comprehensive negotiations with the U.S.Government on post-war financial and economic policy as a whole. Would it not be consistent with this line of approach to lift the currency discussions away from details and mechanics and to try to agree first on certain general basic principles? If such agreement could be reached between the U.K. and U.S. Governments and then be confirmed by the United Nations, an international institution on a brief and easily intelligible basis, including long-term as well as short-term international lending under its wing, might at a later stage prove helpful in carrying out those principles.

In the preliminary stages it is surely Anglo-American agreement on principles that is really important. It becomes daily more evident that in the post-war world sterling and the dollar will be the only important international currencies and that the real concern both of the British Empire and the U.S.A. and of the rest of the world is to see Anglo-American agreement on principles and adequate working arrangements between sterling and the dollar.

Other countries will doubtless tend to group themselves in varying degree around sterling and the dollar; and we know enough of what is in the minds at least of the European allies and France to be sure that we shall meet with few difficulties from them in agreeing on principles.

I attach a rough draft of the heads of agreement at which an approach on these lines might aim; but, for the reasons given above, I make no attempt at this stage to go into mechanical details.

DRAFT HEADS OF AGREEMENTBasic Principles

1. (a) Monetary policy, and in particular exchange rates, although they must be the responsibility of the national Government concerned, are matters of international concern. In shaping policy and in fixing exchange rates, due regard must be had to the effects on, and interests of, other countries.
 - (b) Greatest possible stability of exchange rates is in common interest of all countries.
 - (c) Though all countries have an obligation to do their best to maintain international equilibrium, a special obligation rests on creditor countries.
 - (d) Discriminatory and differential exchange rates are harmful.
 - (e) Disorderly movements of capital from one centre to another must be avoided. In many countries exchange control will be essential to prevent such movements.
 - (f) Maximum degree of freedom for payments on current account (including interchangeability of currencies) is desirable.
 - (g) Although full co-operation and exchange of information are essential, there is no need for world-wide uniformity of practice.
 - (h) Monetary policy should be so designed as to encourage expansion of international trade.
 - (i) Countries must be prepared to give each other help in carrying out policy which conforms with these principles.
2. When, but not before, agreement has been reached on basic principles, first between H.M.G. and U.S. Government and later among the United Nations, it might prove useful to set up an international organisation -
- (a) To provide any international "Clearing House" mechanism which may prove necessary.

- (b) To administer an international short-term loan fund formed either on subscription or overdraft principles to offset temporary deficits on current balance of payments, and, if it judges it expedient, to issue a new form of international credit for this purpose.
- (c) To administer any international long-term loan fund which Governments may decide to set up and to advise Governments on international long-term lending.
- (d) To centralise information about international monetary affairs and to advise in the formation of policies."

In mid-August the Treasury sent the Bank a draft copy of a memorandum to Ministers on the directive to be given to the delegation for discussions on the Keynes and White Plans in the U.S.A. On this occasion also the Bank were not very satisfied with the document, and Mr. Cobbold wrote on 18th August:-

"In general, as you know, we are strongly in favour of keeping firmly to principles and away from technical details, and also of stating specifically that exchange rates must in the last resort be the responsibility of the national Governments concerned.

The draft itself is, in our view, distinctly misleading in two important respects for Ministers who are required to take a decision without being familiar with the technicalities.

First, the references to the attitude of the public greatly understate the opposition to the plans, more particularly in America, where hostility is by no means confined to "some American banking concerns". Informed opinion here is mainly hostile to the American plan.

Secondly, although American co-operation is obviously of the first importance, it cannot, in our view, properly be represented to Ministers that there is no reasonable alternative to a comprehensive international monetary plan: we have no doubt that it would be greatly preferable both for British interests and for world interests to have no

international plan rather than to have a plan in any way resembling the present draft of Stabilisation Fund. It should therefore be made clear to Ministers that whilst agreement on fundamental principles is important, a breakdown on technical plans need not unduly worry us.

To cover the first of these two points a radical revision of paragraph 3 would be necessary. The second could be met to some extent by substituting for the last sub-paragraph of paragraph 8 something on the following lines -

'A deadlock is preferable to the surrender of our minimum requirements as stated above. Surrender would deprive us of a proper degree of control over our own currency, with all that that implies for our domestic economic policy, and might destroy the status of sterling as an international currency. On the other hand the effects of a deadlock would not be particularly harmful. Some working arrangement between London and New York could provide for the continued use of sterling and dollars for international clearing purposes; and our war-time arrangements with allies and neutrals could be adjusted to new conditions. The American experts would be forced to face the real problems of the conditions under which international trade can best be resumed and of the responsibilities of creditor countries. The question of payments could then be reconsidered in connection with the general economic position after the war instead of in isolation, as the American Treasury's present tactics require'.

We have the following more detailed comments on the draft paper -

Paragraph 6 (d). Although we agree that ~~\$4~~ £1 may be a reasonable initial rate we suggest that the directive should make it clear that no sort of undertaking should be given to the U.S. Government on this point until the principles have been cleared up.

We see great disadvantage in giving away this point at any early stage in the proceedings. Before it is given away we should have to consider whether \$4 means \$4 or is shorthand for \$4.03, the present rate.

Paragraph 7 (a) (bottom of page 5). 'The fund must not deal actively in the exchanges of particular currencies' seems to us inadequate, as it leaves the fund to judge what is 'active dealing': the point is that they must not deal at all. We suggest 'The fund must not buy or sell gold or currencies'.

Paragraph 7 (a) (top of page 7). We feel that the paragraph beginning 'Thus, sterling might be exposed.....' understates the dangers and suggests that our only concern is with the loss of profits on foreign exchange business. This is far from being the case and we suggest a redraft on the following lines:-

'Thus sterling would be exposed to action by the Fund, which might both prejudice our control over our own currency and lead to sterling being ousted from its position in international and even imperial trade.'

In conclusion, the summary of instructions in paragraph 9 goes much too far towards acceptance of the White Plan. In particular (and on this point we should if necessary welcome an opportunity of recording our views more formally) we regard as highly dangerous any authority to the delegation to accept 'generally speaking, the model of the Stabilisation Fund', even with the qualifications which follow. We are not even clear what this phrase means (does it, for example, include acceptance of the proposals about abnormal balances, to which we here see great objection?): is it not also contradictory with the first sentence of paragraph 7?

We suggest that paragraph 9 (i) needs redrafting on the following lines:-

'The subscription principle and the limitation of liability may be accepted provided that the form of subscription and the use of the resulting assets are along the lines of 7 (a) and (b) above.' (In your draft by misprint the reference is to 6 (a) and (b).)

and that there should be added an additional clause 9 (iv):-

'When, but not before, agreement has been reached on these points \$4 = £1 may be accepted as the initial exchange rate'."

The Treasury accepted some of these suggestions but felt that the Government was committed to trying to reach an international plan and could not adopt a negative attitude, though a breakdown would be preferable to a surrender of their essential requirements.

On 20th August a telegram from Washington indicated that the Americans expected that the United Kingdom would undertake not to enter upon any new bilateral clearing arrangements, which brought a protest from the Bank (letter 24th August).

"The issue is confused by the use of the word "clearing". As you know, we have as strong a dislike as anybody of bilateral trade clearing agreements on the pre-war German pattern where all trade is forced to pass through Clearing Offices at both ends and where the creditor looks to the Clearing Office for payment rather than to his debtor.

On the other hand, bilateral, and at a later stage multilateral, agreements on the lines of the draft Sterling Area-French Empire Agreement now under discussion seem to us to offer the most constructive and practical initial approach to the problem, a view which we believe has considerable support among the European Allies and the French. We are therefore most strongly opposed to any undertaking which would preclude us or

other countries from making agreements on these lines, whether inside or outside the framework of an international scheme."

A redraft of the memorandum to Ministers was sent to the Bank on the same day. It was found preferable to the earlier draft though still containing passages which the Bank would have liked to see amended.

Shortly after this Lord Keynes and Mr. Thompson-McCausland (lent by the Bank to the Treasury for the occasion) sailed for Washington as part of a delegation to discuss, at the official level only, the currency plans and other subjects (trade policy, commodity policy, etc.) arising under Article 7 of the Lend-Lease Agreement. Mr. Thompson-McCausland was a member of the delegation but was in no sense to regard himself as an official representative of the Bank.