WAR CABINET.

CURRENCY TALKS AT WASHINGTON: EXCHANGE STABILITY.

NOTE BY THE CHANCELLOR OF THE EXCHEQUER.

1. An important question has arisen out of the discussions proceeding between our Delegation and the representatives of the American Treasury on the procedure for securing a reasonable flexibility for exchanges within the framework of a policy for exchange stability.

2. The directive to the Delegation is contained in W.P. (43) 383, particularly paragraph 3 (i) of Sir Kingsley Wood’s covering note, and paragraphs 7 (d) and 10 (iii) of the Memorandum by the Treasury. The general directive was approved in the Conclusions of the War Cabinet on the 2nd September, 121 (43), in the following terms:

   "While countries should retain a reasonable measure of elasticity over their own exchange rates, an endeavour should be made to ensure that decisions to modify exchange rates were taken by reference to some objective test."

3. The original Clearing Union scheme and both published versions of the American Stabilisation Fund scheme contemplated fairly precise rules governing the adjustment of exchanges. The previous discussions between our officials and the American Treasury had made it clear that those rules were too rigid to fit the facts; some qualification would be necessary, particularly for the transitional period and for the problem of the liberated territories. Our Delegation were not given a more precise indication of the principles on which the arrangements might be made because the question forms part of the general structure of the scheme, and there were also questions of preliminary tactics in the discussions which the Delegation would have to decide for themselves.

4. The preliminary discussions in Washington on this matter and the “tentative proposals” submitted in writing to the Americans by our Delegation about the 17th September are shown in Abide 4173 and 4174 (Appendix A). These telegrams were considered by the Treasury and the Board of Trade in consultation with the Bank of England. It was agreed that an automatic adjustment of exchange rates by reference to objective statistics on the balance of payments was impracticable; even in our own country, where the technique of exchange control is well developed, complete data have not yet been evolved.

In agreement with the Board of Trade, the Treasury sent a telegram, 6356 (Appendix A), on the 22nd September, raising questions about the merits of the proposal and the difficult matter of the procedure for approval. The Delegation replied on the 24th September in telegrams Abide 4274 and 4275 (Appendix A).

5. The draft telegram to Washington, Appendix B, represents the view which I took upon the matter. I arranged that this draft should be considered by all the Departments interested, many of whom, however, are disposed to the view that the proposals in 4274 represent a reasonable flexibility for us and reasonable protection against unchecked depreciation by other countries, and that the undeniable difference between the way of approach in Appendix B and
the proposals in 4174 might embarrass our Delegation, and might even be regarded
by the Americans as evidence that we were retreating from the policy of trying
to hold the international exchange position pretty firmly.

6. While these arguments must be carefully weighed, I am impressed also
by other considerations governing this matter which I should like to develop to
my colleagues.

J. A.

Treasury Chambers, S.W. 1.
2nd October, 1943.

APPENDIX A.

From Washington to Foreign Office, dated 16th September, 1943

(No. 4173. Abide.)
Following for Treasury from Keynes:—

In preliminary discussions before the first meeting of the Joint Anglo-
American Committee the British currency delegation considered what proposals
we should make with a view to retaining freedom for individual countries to
vary their exchange rate at need while still giving proper recognition to the
principle of stability. We explored the possibility of a precise objective test or
formula which, if its requirements were satisfied, would confer upon a member
country an undisputed right to vary its rate. We concluded that no precise
formula could be devised which would have a hope of working in practice, but
that certain objective tests of a more general character might be specifically
prescribed, and that this in combination with a limited unfettered discretion
and an emergency right to act in absence of approval might meet the case.

2. Our tentative proposals are given in my immediately following telegram.

3. At the meeting with the Americans I emphasised our belief in the
principle of exchange stability, but outlined the political and economic objections
which were felt very strongly on our side to any attempt to enshrine the principle
in rigid obligations. After sketching our own tentative ideas we handed our
proposals to the Americans as an informal note of suggestions which had occurred
to some members of the British delegation, but which had not been referred to
London and should not be regarded as having any authoritative approval or as
being more than a starting point for discussion.

4. White's preliminary reaction was not favourable.

(a) The United States Treasury desired to avoid rigidity and recognised
the part which flexibility must play in any international scheme.

(b) He was strongly against any precise objective formula, and said that
their own conclusion was that it would be wiser to rely on the collective
judgment of those in charge of the international institution. But he
did not appear to object to our more general criteria.

(c) He recognised that any public discussion of a contemplated movement
in rates was out of the question, but felt sure that in practice any
movement in a major currency would be discussed beforehand between
the three or four major Treasuries. It was inconceivable that there
would not be ample warning of a need for such a move and previous
discussion in the Press. He could not see the objection to providing
in the rules confidential discussions which would be bound to occur in
any case. A suggestion was made and pursued by the Americans that
prior consultation should not be limited to the Chairman, but should
extend either to the Executive Committee, which would be in constant
session and of limited membership, or to a standing Sub-Committee
of the Executive. The Americans appear to have moved away from
the idea of discussions in full session requiring specific majority votes,
but we did not press them to reconcile their new view with the
published draft rules of the stabilisation fund.
While White maintained that confidential discussions between the leading members of the fund could not give rise to speculation, he argued that speculation would in practice be held in check by the exchange controls which he recognised must remain in existence throughout most of the world. He distinguished between exchange controls and exchange restrictions. Controls he envisaged as a machinery of scrutiny which would be maintained even by countries in a strong position, but would normally be administered with the greatest possible leniency. If, however, a country found itself getting difficulties, the control machinery would be administered with increasing strictness to enforce the necessary exchange restrictions for so long as they might be required.

No criticism was offered of the indefinite extension in point of time of the unfettered 10 per cent. discretion or of a bare majority being sufficient for the approval of changes.

3. No attempt was made to reach conclusions. The Americans do not propose to give us their considered reactions until after they have all our suggestions before them.

6. Please inform us as soon as may be whether the note in my immediately following telegram has your general approval. We hope that our treatment of objective tests goes far enough. The American reaction to these proposals seemed favourable, but they expressed relief that we did not ask for precise arithmetical formulas, which would clearly have met with severe criticism.

From Washington to Foreign Office, dated 17th September, 1943.

(No. 4174. Abide.)
Following for Treasury from Keynes:
My immediately preceding telegram.
Following is text lognote:
Exchange rates. 1. Members shall agree not to propose changes in exchange value of their currency unless they consider it essential to correction of fundamental disequilibrium in their balance of payments, and changes shall be made only with approval of the fund subject to qualifications below.

2. Fund shall not withhold its approval if proposed change inclusive of any previous changes since establishment of fund does not exceed 10 per cent. with last ten years.

3. A country which has exhausted its facilities under 2, and desires a further change in par value of its currency in terms of unitas shall, if possible, explain its reasons to fund beforehand and seek fund's prior approval. Fund, in giving or withholding approval, shall act in accordance with following principles: (a) It shall take account of changes in relative money costs of production in country making application, and shall allow an appropriate change if it appears that increase in relative costs has led to an over-valuation of currency. (b) It shall also take into account balance of payments of country making application with rest of world, and shall allow an appropriate change if balance on current account, together with inward long-term capital transactions, has (measured as a percentage of its foreign trade) been seriously adverse over a period, or if country's remaining holding of liquid reserves (measured as a percentage of its quota) is inadequate, provided always that proposed alteration in the exchange seems likely to improve position. (c) Application by a member to appreciate its exchanges shall be similarly considered mutatis mutandis. (d) The fund shall not be entitled to refuse a change on ground of social or political policies which may have led to situation, and shall approve a change which in the de facto situation would tend to restore equilibrium.

4. If circumstances are such that it is not practicable to obtain fund's prior approval to a change, a member shall be entitled if necessary, after consulting chairman, to make a change not exceeding 10 per cent. without seeking fund's prior approval, in which case it shall immediately seek fund's confirming approval. If fund is unable to approve change by a majority vote, the country shall have option of reversing it and of conforming to views of fund or shall withdraw from membership without further notice given.
Foreign Office to Washington, dated 22nd September, 1943.

(No. 6356. Abide.)

Following for Revues from Treasury: —

Your telegrams Nos. 4173 and 4174 [Exchange Rates].

1. It is not clear from paragraphs 4 and 6 of 4173 whether Americans dislike the objective criteria suggested by you, which seems to us on sound lines, or the principle of an appeal to objective data as justification for altering exchanges in place of reliance upon collective judgment of executive committee. But in either case their present attitude underrates difficulty of persuading Parliament that in an instrument which is to have something of the sanctity of a Treaty the Government should surrender the right to protect employment by exchange adjustment, which is regarded in many quarters as appropriate defensive action. Similar point is bound to be raised by other countries such as Holland, Belgium, France and Latin American countries, and we should have expected Congress also to take it. If the main clause dealing with exchange rates were to be too rigid, there would be a risk of insistence or great emphasis on escape provision or that acceptance would be subject to undisclosed reservations. Neither situation would be satisfactory as we think you will agree that genuineness of approach is essential to this part of proposed international set-up.

2. At present tentative stage of discussions instructions to you are undesirable, but you ought to know our reaction to American attitude as we understand it from your telegrams.

3. There is an obvious relation between the clause dealing with exchange adjustments and the general form of the whole scheme. The present published American scheme may remain in the background of your present discussions, but we assume that it still is in existence. It could be represented as having the appearance of a gold standard scheme, and precise exchange obligation in such a scheme would be regarded as tying us to a gold standard dollar.

4. It is not clear from paragraph 10 of your Abide 4125 at what dates and by what stages after the war the scheme is to come into operation. The range of exchange adjustments which is permissible could be much more easily seen when we know something about the relative levels of prices and production costs that will follow upon the early unsettled post-war period. Several Europeans have expressed view that initial exchange rates would have to be experimental. We agree with this, and in such circumstances precise definition of ranges of adjustment seems to us unwise at this stage.

5. The reality of the conditions under which consultation would be conducted must be appreciated by White. It is true that in countries which retain exchange control the draining away of resources which normally precedes exchange adjustment could to a considerable extent be checked. But if situation is developing where a major adjustment of exchange rates is on the horizon exchange control would soon show itself an imperfect instrument. In such a situation consultation would have to be very speedy and very confidential. So long as the central monetary authority is not manifestly disturbed, exchange values could be reasonably held with the help of exchange control. But once it leaks out that discussions are proceeding which would be likely to lead to an exchange adjustment of significance, pressure upon exchange value would become insistent. Moreover, White's idea seems to us to presuppose free dealings even in currencies which are subject to control, and any major currency would therefore be open to attack during consultation. We think it would be wiser for the moment to put aside detailed definitions and to be content with a clause by which member countries agree not to make changes in the exchange value of their currency unless they consider it essential to correction of fundamental disequilibrium in their balance of payments, and then only after consultation with the appropriate committee of the Board. We should hope undertakings to consult would be more effective in practice than obligation to obtain formal approval. Moreover, we believe that at this stage it would not be practicable to obtain agreement that changes should be subject to approval by any system of voting of the governing body. The clause could also have a descriptive statement of the objective conditions that might constitute evidence of the fundamental disequilibrium on the lines of paragraph 3 of your 4174.
6. We are in general agreement with the idea in (c) of paragraph 4 of 4173 that in the ultimate analysis all the issues involved in the whole scheme will rest upon the judgment and competence of the management of the scheme. We suggest that it is not inconsistent with this view that, for the starting period, we should be content with a firm statement of adherence to the principle of exchange stability and agreement to consult before making change. As the situation develops the management would doubtless be able to elaborate closer definitions to which member States would be willing to agree.

7. Paragraph 5 of your 4173. You and your colleagues must be judges of the development of tactics in the discussions, but we do not want to slide into a position in which each suggestion we make is put forward in detail apart from general consideration of the whole scheme, so that the Americans may attempt to dispose of each one separately without proper regard to the shape of the scheme as a whole. You are fully aware of this, and we mention the point only because your express reference to us of the problem of exchange rates has come rather in isolation.

From Washington to Foreign Office, dated 23rd September, 1943.

(No. 4274. Abide.)

Following for Treasury from Keynes:

Your telegram No. 6356.

Indications are that the Americans will accept, subject to only minor modifications to the principles laid down in paragraph 3 of my 4174. What they disliked was any attempt to make these criteria arithmetically precise, a view with which we have considerable sympathy.

2. We are not overlooking the consideration urged in your paragraph 3. White has now had all our substantial proposals and the Joint Group will have had them by tomorrow. We will emphasise again that they all hang together in our minds and difficulty about any one of them might have repercussions on other points, since each of our detailed suggestions has to take in the framework of our suggestions as a whole.

3. Your paragraph 4, which has arrived possibly corrupt. We felt that the difficulties of the initial period would be sufficiently met by unqualified discretion to make 10 per cent change. Our proposals, however, were mainly concerned with longer term. We might strengthen the provision relating to the early period with a clause similar to the concluding passage of Clearing Union 6 (3).

4. We are not clear how far the last sentence but three of your paragraph 5, in conjunction with your paragraph 6, qualifies readiness to accept draft proposals in my 4174. Our latest impression is that the Americans will accept the whole of these proposals subject only to minor modifications. The above sentence of your paragraph 5 would modify paragraph 4 of my 4174 in two respects. It would allow [group undecipherable] the right of action to the Fund if its advice is disregarded and would apply unilateral changes of any size. It would be a very drastic change to propose that every country should be free to make unlimited unilateral alterations in its exchange merely after consultation. All of us here think that the proposals of 4174 give sufficient elasticity and independence and would be sorry to have to go back so completely on the idea of having some definite rules to preserve exchange stability. Our draft already preserves an ultimate freedom of action to [group undecipherable: ? every] member. Please let us know very urgently if we are to withdraw the proposals of my 4174, which, unless we have misunderstood your telegram under reference, seems to us more in conformity with the Cabinet directive. If we are to withdraw them we should not delay in doing so. We fear the effect of withdrawal on discussion as a whole, which is exceedingly satisfactory. White has indicated to me privately that in the last resort he would not resist any of our fundamental principles as so far propounded to him, provided that we are successful in persuading his colleagues.
From Washington to Foreign Office, dated 23rd September, 1943.

My immediately preceding telegram. Following from Waley:

With the permission of Keynes I would like to set out my views. To comply with the Cabinet instructions we have—

(a) To avoid being forced to deflate if His Majesty's Government should at any time think, rightly or wrongly, that it would be better to depreciate and that this would avoid deflation.

(b) To prevent other countries depreciating for competitive reasons on the pretext that this would correct a disequilibrium when by some test as objective as possible it could be shown that this pretext was not justified.

(c) To avoid bear speculation which would be caused by formal consultation with fund beforehand. It seemed to me that on the whole our proposals met all three points.

A. Apart from special latitude which might be necessary in the immediate post-war period, it seems to me that it will be a very important achievement if we can secure freedom to depreciate to the extent of 10 per cent. unilaterally.

B. Obstacles to further depreciation without real justification seems to me as effective and as objective as could be hoped.

C. Arrangements for making changes without consulting the fund beforehand seems to me to avoid the danger of bear speculation.

2. I am surprised to find so little emphasis in your telegram on the danger of depreciation by other countries for inadequate reasons. At first reading the promise to depreciate only in order to correct disequilibrium, and then only after consultation, seems more attractive than our proposal from the point of view of avoiding any appearance of again crucifying ourselves on the cross of gold or submitting our affairs to the decision of an untried international body. But I think that this appearance is to some extent deceptive. In practice in view of our position in the world and our intimate relations with the United States, it will be very difficult indeed for us to depreciate unless the committee of the fund approve. It will be far easier for many other countries to disregard the advice of the fund.

3. The prospect that the Americans will agree to the terms of the proposals taken as a whole appears unexpectedly favourable. This particular point must be judged against that of the general background. Taking a severely practical point of view, our proposals give us completely free hand to depreciate to the extent of 10 per cent. and another 10 per cent. without the necessity of securing committee's approval whilst laying down satisfactory rules on circumstances in which countries should or should not be allowed to depreciate further. Your proposal in practice might well mean that we could never depreciate at all without obtaining prior approval of the fund or its committee whilst others will feel less embarrassment in acting against the wishes of the fund.

4. Even if you are not at all convinced by these arguments the position probably is that we may have the choice of some international monetary arrangement on lines of our present proposals or no international monetary arrangement at all. The general view among the Americans here is that if we fail to reach agreement on monetary arrangements there is much less chance of reaching any definite understanding about commercial policy, in which field there is also an unexpectedly large measure of agreement between American views and those of His Majesty's Government.
APPENDIX B.

To Washington.

(Abide 4274 and 4275.)

1. Question has been considered by Ministers. While present discussions are, and remain, non-committal so far as Government is concerned, you would wish when important issues define themselves to know what Ministers believe Parliament would accept. Moreover, circumstances out of which present discussions arose put upon us some responsibility for considering position of other countries. We do not want situation to develop where we and Americans are expected to railroad an agreement through reluctant United Nations.

2. We appreciate fully the intention of your proposals in 4174 that each country should have limited unilateral rights giving reasonable flexibility, but that unilateral rights should not lead to unchecked irresponsibility.

3. The two issues raised by your proposals are whether proposed rules are suitable and whether procedure of approval or consultation is to be preferred.

4. But there is a third issue: Whether there should not be clear distinction between rules and procedure appropriate to transitional post-war period and those appropriate to later position.

5. It is generally agreed that for many countries initial post-war rates must be experimental. Revised Stabilisation Fund scheme recognised problem of liberated territories, and Clearing Union scheme recognises difficulties of transitional period. We think it quite premature to estimate now whether permissible range of 10 per cent. will meet inevitable adjustments of experimental rates. If any such figure were inserted at this stage it would have to be surrounded by numerous qualifications for liberated territories and other problems and the quoted percentage would have little real meaning. The instrument creating the currency organisation is to have something of the sanctity of a Treaty and all conditions bound to precise figures would need to be looked at very closely in order to make sure that the figure would stand up to unexpected developments. Change of any figure in the instrument might obviously involve complicated and long-drawn-out procedure.

6. While we agree that as between ourselves and United States the practical difference between consultation with the Board and approval of the Board is qualified by argument in paragraph 2 of 4275, the difference in form between consultation and approval is real. We cannot yet know the size of the Board or the constitution that will emerge. Approval must contemplate possibilities of difference of opinion on Board, and therefore must provide voting procedure. Quite apart from our belief, which we know you share, that important business of the Board cannot really be conducted by voting, all questions of voting on this matter will raise Parliamentary difficulties, and also probably difficulties with other countries. Most countries have recollections of decisive voting influence at Geneva of countries often remotely concerned with effect of issues before many League Committees.

7. The third issue mentioned in paragraph 4 raises question when it is hoped that international currency organisation might be in operation. Despite obvious difficulties we believe that it is highly desirable that organisation should be in existence as early as possible in the transitional period and should be able to gain experience and exercise influence in the difficulties of that period. This, in our judgment, probably entails setting Board up with limited powers of formal approval but with wide and growing powers of influence, leaving the Board as it gains experience on this difficult territory to develop more precise rules. If the Board acts wisely and cautiously it will gain general acceptance and its position will become very strong. We do not believe that its position will be made any stronger by premature grant to it of specific powers of detailed approval and disapproval.

8. In the light of the foregoing we restate for you the views we should wish you to urge strongly upon the American representatives:

(a) There should be definite agreement to accept stability of exchanges as foundation of international economic relations.

(b) Exchange adjustment should be in accordance with objective principles. We agree with American view that precise mathematical tests are probably impracticable and certainly premature at this stage. You
will recognise difficulty of providing unchallengeable data on balance of payments even with our own elaborate technique of exchange control. We like the objective principles in your 4174 and think they could well be enshrined in text of instrument.

(c) We should wish to see Board in existence as early as possible after termination of hostilities and able to exercise influence upon the problem of exchanges in transitional period.

(d) There should be agreement in the instrument that no adjustment of exchange rates shall be made except after consultation with the Board, though not subject to the Board’s approval. It is for discussion whether the initial exchange rates fixed should be subject to consultation with the Board or only subject to notification. We would have no objection to consultation, though it would have to be recognised that the views of the member countries on the experimental rates would normally have to be accepted. We would much rather introduce the doctrine of consultation from the beginning than a mathematical range of adjustment allowed without consultation.

9. At the conclusion of 5 years from the setting up of the Board or at such earlier period as might be agreed upon by the member countries, the Board should be required to formulate for consideration by members rules governing procedure for adjustment of exchanges. At that stage it might well be possible to introduce ranges of adjustment such as you contemplate, and certainly it might be practicable to provide for more formal approval by the Board if satisfactory procedure for rapid action could be evolved.

10. We hope you will not feel that this approach to a crucial problem involves a withdrawal from the tentative proposals in 4174 which would embarrass you in your discussions. You will see that we have tried to put our policy in a positive manner which you could urge upon the American representatives. On these lines we believe we could carry influential opinion not confined to this country.