5

Sept. 29, 1943

Mr. White

Mr. Luxford

Since the "sovereignty" cliché is being tossed in opposition to every proposal on the part of the United States in the field of post war international cooperation, I have had Bremer of this office prepare a memorandum discussing the matter from a legal point of view.

You may find this of some interest and as background for the issue should it be raised on the Hill at the Secretary's next appearance.

(Initialed) A.F.L.

Copies to: Mr. Paul
Mr. O'Connell
Mr. Pehle,
Mr. E.M.Bernstein

Attach.

AFL:mrd - 9/29/43.

MEMORANDUM

September 25, 1943

The proposal during recent months of a number of plans designed to improve international relations in the post-war world has resulted in considerable discussion of the nature of the obligations which will be assumed by nations participating in these and similar plans. There is an increasing tendency to attempt a solution of global problems by united action on the part of all the major countries of the world rather than through individual or bilateral action. This approach necessarily assumes that many multilateral treaties will be entered into, each covering a specific matter of universal concern. Some of the proposals envisage the creation of international organizations each charged with the administration of a particular field of international contacts. One example is the proposal for an International Stabilization Fund.

The scope of the proposals, particularly the creation of important international organizations, has raised in the minds of many people the question of whether the execution and performance of the contemplated treaties involves a "surrender of sovereignty" by the participating governments. Since this question is directed at one of the basic principles on which the framework of much post-war work is being built, it is important that it should be carefully analyzed at this time.

The concept of sovereignty has been a troublesome subject in the writings of many publicists in the field of international law. This difficulty is due, in part, to the conflict between the classic definition of sovereignty and the actual practice of nations whose sovereignty is unquestionable. The classic definition of a sovereign nation which has prevailed since the time of Grotius is that it is one whose actions are not subject to the legal control of another. 1/ This statement becomes inadequate when applied to the actual practice of nations unless "legal control of another" means only that control exercised directly by one nation without the consent of the other. Otherwise sovereignty is nothing more than an abstract idea and could exist only in a world where there were no international frictions or collisions of any nature whatsoever. It is from the unreal construction of this definition, which fails to take the essential limitations into consideration, that the concept of the "surrender of sovereignty" has evolved.

---

1/ Hugo Grotius (1646), De Jure Belli ac Pacis Libri Tres, p. 66.

Obviously, if sovereignty necessarily includes an absolute freedom of action in every field, no nation can handle its international relations through cooperation with other nations, individually or in groups, unless it is willing to surrender a part of its sovereignty. The theory thus embodies an additional concept that sovereignty is divisible. Not only must it be divisible, but it must be capable of being broken into innumerable pieces whose size and importance are extremely varied. 2/

Those who are concerned about the possibility of sovereignty being surrendered overlook the logical conclusion which would follow the attempt of any nation to maintain its sovereignty, in the unlimited classical sense, unimpaired. The treaty as a vehicle for the solution of international problems is not a recent development. It has been used for centuries—practically every nation in the world having entered into such agreements for many purposes—and yet no nation after entering into a treaty of any importance maintains its sovereignty according to the unlimited classic definition. Since a treaty binds it to take a particular course of action, either positive or negative, its freedom to act is circumscribed to the extent of the area covered by the treaty. Nor is this obligation one which a nation may observe or abrogate as it pleases. It is true that there is no power which can enforce the obligations of a treaty which one party decides to abrogate, but this does not mean that there is no legal obligation. The fact that an obligation can not be enforced against a nation without its consent is a matter of procedure and does not affect the legal status of the obligation. 3/ Thus it seems clear that adherance to the unlimited classic definition of sovereignty leads to the inevitable conclusion that sovereignty is constantly and consistently being surrendered by every nation in the world. Such a conclusion is an obvious absurdity and one which has clearly been rejected by the Supreme Court of the United States when, in Steward Machine Co. v. Davis (1937), 301, U.S. 548, 597, it said, "Even sovereigns may contract without derogating from their sovereignty."

To cite all the examples of past and present treaties which would involve a "surrender of sovereignty" in this sense, would be a tedious and useless task. In fact, it is difficult to imagine a treaty of any importance which would not result in one party or both having something less than absolute freedom of action in every field. Accordingly, it should suffice to describe several of the best known classes of treaties. First, there are disarmament treaties which restrict the right of the participants in providing arms for their own defense. Next, there are customs unions which reduce sources of income and prevent the erection of tariff barriers for the protection of domestic producers. Another example is the trade agreement or commercial treaty that, among other things, requires the provision of most-favored-nation treatment. And finally, there are treaties binding the contracting nations not to fortify particular borders,

---

2/ W. Sukiennicki (1927), La Souverainete des Etat en Droit International Moderne, p. 87 ff.

3/ Perry v. United States (1935), 294 U.S. 330, 353.

thus restricting the use which each country can make of its own territory. The types chosen have been selected because they are prevalent today and not because they are particularly convincing. However, they do indicate clearly that the existence of treaties is inconsistent with the unlimited classical concept of sovereignty.

All this confusion is unnecessary if a direct approach is taken to the problems involved in international relations. The unlimited classic definition of sovereignty serves no useful purpose. It is not the basis upon which any rules of international conduct are founded and it fails to fit not only the existing status of independent nations but the status which such nations have enjoyed since the doctrine was first expounded. Probably the first man to expound the doctrine was Grotius. First, he stated the rule and then he proceeded to give striking examples of sovereign nations whose status failed to meet the tests of his own definition as it was later interpreted by some students of international law. Grotius not only recognizes that the existence of a treaty between two nations does not diminish or surrender the sovereignty of either nation, but he points out that even in the case of an alliance or treaty which gives one contracting party a permanent advantage over the other, the less favored nation retains its sovereignty so long as it remains independent. According to him, the same rule applies to nations paying tribute. 4/

Some later publicists followed the definition propounded by Grotius, but failed to consider his application of the rule. 5/ A synthesis of the rule and its application would lead to a definition quite different from that which is commonly adopted. A sovereign nation would be defined as a nation which is not subject, without its consent, to direct restraints by other nations upon its activities. Such a definition connotes independence, but does not make impossible the orderly arrangement of international affairs through treaties and other agreements. In addition, it recognizes that the rules of conduct agreed upon in a treaty are not imposed by a higher authority than that of the parties to the

---

4/ Hugo Grotius, op. cit. supra, pp. 66-69

5/ Westlake (1894), International Law, p. 87
I Lauterpacht (1937), Oppenheim's International Law, p. 117.
Taylor (1901), International Public Law, p. 423.
Eagleton (1942), Organization of the Community of Nations, 36 American Journal of International Law pp.229, 234.
Mackenzie (1939), American Contributions to International Law, Proceedings of the American Society of International Law, pp. 104,105.

treaty but are established by the nations themselves in order to facilitate the conduct of their mutual affairs, and are dependent for their enforcement upon the good faith of the contracting nations. 6/

Defining sovereignty so as to permit the making of international treaties and agreements without giving up any of the attributes of sovereignty, recognizes that the essence of national sovereignty is similar to that of individual liberty. Free men must establish rules governing their conduct or they will find it impossible to live together. Similarly, every nation must conduct its external affairs in the same world in which other nations have important rights and interests. The meaning of individual liberty in all civilized society is liberty exercised in a manner which will not interfere with the liberty of others, with the functioning of a free and orderly society, or with the existence of a strong and effective government. If these qualifications on the concept of liberty are considered as surrenders of liberty, then real freedom would mean anarchy. Similarly, the classic definition of sovereignty would mean world chaos if nations were concerned with the preservation of their sovereignty as so defined.

Having arrived at a definition of sovereignty which adequately covers the existing status of free and independent nations, it is necessary to examine the proposal for an International Stabilization Fund in the light of that definition. In brief, each member country would undertake the following: 7/

(1) To maintain rates of exchange established by the Fund;
(2) To refrain from exchange dealings which would undermine stability of rates established by the Fund;
(3) To abandon restrictions over foreign exchange transactions when, in its own judgment, conditions permit such action;
(4) To refrain from establishing new restrictions on foreign exchange transactions without the Fund's approval;
(5) To keep the holdings of the Fund in its currency free from restrictions;
(6) To cooperate with other member countries in regulating international movements of capital;
(7) To avoid new bilateral clearing arrangements and multiple currency practices;

---

6/ Taylor v. Morton (1855 C.Ct. Mass.) Fed. Cas. 13, 799;
Whitney v. Robertson (1888) 124 U.S. 190;
The Chinese Exclusion Case (1889) 130 U.S. 581;
The Cherokee Tobacco (1870) 11 Wall. 616;
Rainey v. United States (1914) 232 U.S. 310.

7/ Preliminary Draft Outline of a Proposal for an International Stabilization Fund of the United and Associated Nations, Revised July 10, 1943.

(8) To consider the views of the Fund on policies which affect the balance of payments of other countries;
(9) To furnish the Fund with information and reports; and
(10) To adopt legislation to carry out its undertakings to the Fund.

The last of these requirements is the principle one which has raised doubts in the minds of those who think in terms of sovereignty being surrendered. Can it be inferred from the question that a nation with whom the United States makes a treaty has no right to expect and require its stipulations to be adhered to? If this inference is not justifiable, and it appears to be clearly unsupportable, then the tenth requirement adds nothing to the proposal since each nation would assume the same responsibility even in the absence of an express provision. 8/

As for the other requirements, little discussion is required. Obviously no question would arise if any one of them were embodied in a treaty between the United States and one other nation. Nor would there be any doubt about any one of them appearing in a multilateral treaty to which the United States were a party. Accordingly, there should not be any serious query as to the propriety of all of them being included in an agreement entered into by all of the major nations of the world.

Thus it appears that, applying the real meaning of sovereignty, participation in international organizations, such as the proposed International Stabilization Fund, will not be a "surrender of sovereignty". On the contrary, participation will be the exercise of the sovereign right of every independent nation to bind itself to a given course of action in a specified field of international contacts in order to establish satisfactory international relations.

---

8/ Taylor v. Morton (C.Ct. Mass. 1855) Fed. Case 13, 799.

RB:ec 9/25/43

MEMORANDUM

October 23, 1943.

There is attached a copy of a memorandum entitled "Sovereignty Under the White Plan," prepared at the Federal Reserve Bank of New York, which concludes that the plan does not really involve a fundamental surrender of sovereignty. The writer had before him only the printed edition of the proposal for an International Stabilization Fund. The following discussion considers the points made by him in the light of the proposal and also in the light of the changes resulting from the conferences with the British experts.

The memorandum refutes the idea that participation in the Fund would involve a "surrender of sovereignty" on the basis that a member country is free to withdraw from its obligations to the Fund, and then proceeds to indicate that this conclusion is a doubtful one. The points which are troublesome for the writer are first, that withdrawal becomes effective only one year after notice is given, and second, that it is implicit in the plan that the authority of Congress to regulate the value of the dollar will be delegated to some extent to the Fund.

The writer's general observations on the sovereignty question are subject to criticism from several angles. His reliance on the right to withdraw from the Fund as the answer to the "surrender" argument is rather shortsighted. It is not necessary that a nation, to preserve its sovereignty, refrain from entering into international agreements from which it may not withdraw at will. On the contrary, the withdrawal privilege is an unusual provision and the real fallacy in the "surrender of sovereignty" argument lies in the fact that it is based upon an erroneous concept of the meaning of sovereignty as applied to a nation in the modern world.

Even should the writer's approach be considered an adequate treatment of the sovereignty question, his memorandum could be considerably strengthened by reference to the Joint Statement by the Experts which will serve as the basis for the work of the drafting committee, and also by a better understanding of the powers of the Fund. The conferences with the British experts resulted in a change of the withdrawal provision which makes possible the withdrawal of any member country at any time and it seems clear that this change would dispose of the writer's concern with the former requirement that one year's notice be given. On the question of the delegation of congressional authority to the Fund, the writer is apparently in error. The provisions in the printed proposal and in the Joint Statement are to the effect that the value of a country's currency may not be changed without its consent and that the gold values of all currencies may not be changed except with the approval of 85% of the member votes. Since the United States will have a veto power over any general change and must consent to a specific change in the value of its own currency there is no problem of delegation involved.

The writer divides the obligations and powers into three classes: (1) the ability of a member country to obtain foreign exchange from the Fund; (2) the obligation of a member country to refrain from certain action; and (3) the obligation of a member country to take certain action. He concludes that the first group does not involve any interference with national sovereignty since the conditions which may be attached to the provision of foreign exchange may be avoided by the member country refusing to accept the exchange. His point that the conditions which may be attached are similar to those customary in the case of loans seems to be well taken. With respect to the second group he is not quite convinced. Although he recognizes the analogy to treaties binding a country not to build battleships or raise tariffs he feels that this plan involves certain fundamental differences. He states that the policy obligations assumed by the country may be changed if the Fund consents, so that a member country's policy is subjected to the judgment of the Fund. In this connection it should be noted that the proposal does not envisage changes in a country's policy by the Fund unless the country agrees with the change. This agreement must be obtained either by the inclusion of that country's votes, or by the acceptance of the Fund's recommendations. He also points out that the penalty for withdrawal from the Fund is heavier than that involved in the abrogation of a trade agreement. Although this may be true, it can be so only on the basis that the advantages of membership are commensurately greater than those pertaining to trade agreements. With respect to the third group, he concludes that positive action is never required but only recommended by the Fund. (In addition to answering the question with respect to this group of obligations his conclusion is also an answer to the question he raises concerning changes in the policies of member countries by action of the Fund.) The memorandum continues with a brief discussion of various provisions of the printed proposal which fall within the three categories of powers and obligations defined by the writer.

I. (Group 1)--Conditions attached to loans.

The printed proposal provides that the Fund can not engage in transactions in a particular currency until its rate had been established with the approval of the Fund and the member country. The writer interprets this as meaning that the member country will have to accept the rate decided upon by the Fund. There would be some justification for such an interpretation if the Fund were in a strong position prior to the establishment of initial rates. However, it will not be in such a position at least until the major countries have reached an agreement with the Fund on the initial rates. Moreover, a country will not have voting rights prior to the establishment of a rate and, accordingly, will be in the same position as if it had not joined the Fund. The writer erroneously assumes that such a country will have voting rights. (IV, 2, a, par. 2)

The conclusion that this group only involves conditions similar to those imposed on loans is supported by the writer by quoting the sections imposing such conditions upon a member country exceeding its permissible quota or rapidly exhausting its permissible quota. The latter provision has been excluded from the Joint Statement and the former has been reduced to a provision that exchange may be provided in addition to the permissible quota under appropriate safeguards. (V, 2, b and d)

II. (Group 2)--Obligations to refrain from action.

The provision that member countries will maintain the rates established by the Fund and will alter the values of their currencies only as provided in the Agreement is criticized on the basis that the Fund can change values with a three-fourth's vote, which action will be resented by the legislative branch of the Government. This point is not well taken since the value of a currency can not be changed without the consent of the country concerned. Under existing law in the United States such a change could not be made in the value of the dollar without action by Congress. (VII, 1.)

This same criticism is directed at the obligation not to engage in exchange dealings which will undermine the stability of the rates established by the Fund. Even if the criticism were valid in the former case it is difficult to see its applicability to this provision. (VII, 2)

The memorandum criticises the provision that no new restrictions on foreign exchange transactions with member countries will be imposed without the approval of the Fund on the basis that refusal to approve of such restrictions, coupled with the obligation to maintain stable rates, can force a member country to use up its exchange reserve. This criticism appears to be an attempt to justify the use of exchange controls as a means of combating exchange problems. However, exchange controls are one of the devices which the Fund is designed to eliminate in the field of current transactions. (VII, 3, par. 1)

The obligation to keep the holdings of the Fund free of restrictions as to their use is made the subject of a fantastic criticism. The writer points out that a country which exhausts its permissible quota might fail to pay off its obligations to the Fund, in which case the Fund could induce other countries to make their payments to this member through the Fund, thus reducing the obligations of that country, but also cutting down its exchange receipts. In such circumstances, he states, the country might wish to freeze the Fund's balances. Although he is quite right in assuming that a country would wish to take action to prevent such tactics, it is difficult, if not impossible, to see how the Fund could engage in such tactics. This is particularly true under the Joint Statement which provides that the Fund's holdings shall be free only to the extent necessary for it to carry out the operations specified in the Agreement. (VII, 3, par. 3)

The provision that members will not enter into new bilateral clearing arrangements or multiple currency practices which would retard the growth of world trade is apparently approved, but the writer states that the Fund might have difficulty in preventing underhand practices when a member country establishes quantitive import controls. It is difficult to determine the meaning of this observation. (VII, 5)

III. (Group 3)--Obligations to take action.

The writer finds no difficulty in connection with several of the requirements of this nature since member countries are only required to consider the requirements of the Fund. The provisions of this type are those dealing with abandonment of foreign exchange restrictions, the handling of scarce currencies, and the view of the Fund on problems which might cause a serious disequilibrium in the balance of the payments of member countries. (VII, 3; V, 4; VII, 6)

The writer believes that the obligations to furnish information and the obligation to adopt appropriate legislation are of purely technical significance. This appears to be a sound conclusion. (VII, 7 & 8)

In connection with the provision dealing with the deposit of collateral when the Fund's holdings of a particular currency exceed the permissible quota of a country does not cause the writer any difficulty, but he states that the Fund might ask for collateral after a loan had been made. It is difficult to see how such action could be taken. (V, 2, c.)

RB

Mr. Knapp... FRB of NY

CONFIDENTIAL

SOVEREIGNTY UNDER THE WHITE PLAN

A brief survey of the literature on sovereignty reveals that in this field, as in most others, there exist a "classical," a "modern," and several other theories. According to one interpretation, sovereignty implies the absolute freedom of action of the State, unhampered by any kind of restraint. In this sense, no country is wholly sovereign, least of all the United States, which, as the Encyclopedia Britannica observes, is more securely bound by her treaties than any other. A second school maintains that a country is sovereign as long as it assumes no obligations which would prevent it from ultimately regaining its freedom of action. Under this definition, which to me seems the more sensible of the two, the White Plan does not fundamentally interfere with sovereignty because

> "Any country may withdraw from the Fund by giving notice, and its withdrawal will take effect one year from the date of such notice. During the interval between notice of withdrawal and the taking effect of the notice, such country shall be subjected to the same obligations as any other member of the Fund." (VI - 11)

Each country thus preserves the right to regain its freedom of action, and hence its basic sovereignty. This is particularly true of countries that may choose to withdraw while they are creditors, which might be the case of the United States. Such countries would not be under obligation to make any subsequent payment to the Fund. The only question here seems to be whether the one-year clause might be regarded as interfering with the sovereign right to regain immediate freedom of action.

With respect to the United States a special reservation should perhaps be made. Unlike the position in some other countries, sovereignty in the United States resides in the people, not in the central government, which is a government of limited powers. Consequently, it may be that what some persons would have in mind in charging that the White Plan impinges upon our sovereignty is the thought that no delegation of powers to the Fund by Congress could be made without restricting the people's sovereignty and violating the Constitution. No such question arises in a country like Great Britain, where no written constitution exists and Parliament is free to bind the country to any course of action in any and every field. Whether the power granted to our own Congress in the Constitution, to regulate the value of the national currency, can be interpreted as empowering it also to delegate the power to regulate that value (as it would to some extent be doing by subscribing to the White Plan), is a purely legal question on which an economist hesitates to pronounce himself.

Unless legal opinion should decide otherwise on this particular point, it would seem that even for the United States, and certainly for many other countries, an issue of basic sovereignty is not involved in the White Plan. It does not follow by any means, however, that the obligations imposed by the White Plan can be assumed unhesitatingly. For to assert its sovereignty and to rid itself of these obligations by giving notice, is a grave step for any country. To a small country it means the loss of credit standing; to a large one it implies responsibility for wrecking the Fund. As long as membership is maintained, on the other hand, these obligations are very serious, even though they do not interfere with sovereignty. In the case of the United States, particularly, the danger exists that any right of the Fund to interfere in our policies will be used to make us, as the richest country, share some of our resources with others. It is not impossible that such outside influence might be directly beneficial even for ourselves, in case one assumes that we would otherwise fail to make use of our full resources. If, on the other hand, we are confident of being able to pursue an intelligent policy of our own, it seems clear that outside influence can contribute to our welfare only in an indirect sense, in so far as without conceding such influence we could not expect to have orderly international relations.

After this discussion of the broader aspects of sovereignty under the White Plan, we pass to a detailed analysis of the powers of the Fund and of the obligations of the members. These powers and obligations may be classified according to the following three cases:

(a) The Fund offers to sell exchange to a country provided it adopts certain policies. If the country refuses, the Fund withholds assistance.

(b) Members agree <u>not to undertake</u> certain steps without the Fund's approval. No question of assistance is involved.

(c) Members agree <u>to take</u> certain steps, either unconditionally or at the Fund's request, without there being any question of assistance.

In case (a) the Fund acts like a banker. It offers money under certain conditions and the country may take it or leave it. Practically all international lending in the past has been based on this principle. To call the conditions attached to a loan an act of interference seems hardly justified, although charges of this kind very probably will be made. Case (a) is the situation to which Mr. White repeatedly referred at the meeting when questions of sovereignty were raised.

Case (b) is analogous to international treaties in which countries bind themselves not to do certain things, for instance, not to build battleships or not to raise tariffs. Two important differences must be noted, however: (1) The policy obligations assumed under the White Plan are not unalterable, for they can be set aside if the Fund consents. This flexibility is necessary, but it also creates uncertainties and subjects the member's policy to the judgment of the Fund. Similar elements are not involved in an ordinary international agreement. (2) The penalty for leaving the Fund is very much heavier than that connected with the abrogation of a trade agreement. For these two reasons there can be no question but that a country's freedom of action is restricted considerably as long as membership is maintained.

Case (c), in which the Fund tells a country to take certain steps, is at first sight the most troublesome, because interference here has a positive instead of negative, i. e., restraining character. The following review of individual clauses will show, however, that instances of case (c) are infrequent in the White Plan and that generally they have only technical significance.

I. Case (a) - Conditions Attached to Loans

> Clause IV-2-a, par. 2 - "No operations in such currency shall be undertaken by the Fund until a rate has been established which has the approval of the Fund and of the member country in question."

This clause requires a member to consent to a rate which is acceptable to the Fund, if it wishes to get money from or receive payment through the Fund. It is a plain matter of take it or leave it. The voting rights of the member presumably remain unaffected. This clause can be used to delay operations with a country not yet qualified to deal with the Fund.

> Clause V-2-b - "When the Fund's holdings of local currency and securities are equal to the permissible quota of a country, the Fund may sell foreign exchange for such additional local currency only with the specific approval of the Board of Directors (cf. VI-3-a, below), and provided that at least one of the following two conditions is met:
>
> (i) In the judgment of the Fund satisfactory measures are being or will be taken by the country whose currency is acquired by the Fund, to correct the disequilibrium in the country's balance of payments; or
>
> (ii) It is believed that the balance of payments of the country whose currency is acquired by the Fund will be such as to warrant the expectation that the excess currency holdings of the Fund can be disposed of within a reasonable time."

Here again the country is required to meet certain conditions if it wishes to buy exchange. If the conditions are too onerous, it may do without the exchange.

> Clause V-2-d - "When, in the judgment of the Fund, a member country, whose currency and securities held by the Fund exceed its quota, is exhausting its permissible quota more rapidly than is warranted, or is using its permissible quota in a manner that clearly has the effect of preventing or unduly delaying the establishment of a sound balance in its international accounts, the Fund may place such conditions upon additional sales of foreign exchange to that country as it deems to be in the general interest of the Fund."

This is the clause which allows the Fund to impose conditions upon borrowing as soon as the member has drawn down the equivalent of its gold contribution. Mr. White emphasized the importance of this clause at the meeting. No doubt it is capable of giving rise to disputes, but it can hardly be regarded as signifying interference, since acceptance of the Fund's conditions is optional.

II. Case (b) - "Don't" Clauses

> Clause VII-1 - "To maintain by appropriate action exchange rates established by the Fund on the currencies of other countries, and not to alter exchange rates except as provided in IV-5, above."

This is perhaps the most important commitment in the whole plan. If all changes of rates were thereby ruled out for good, there obviously could be no charge of interference, any more than such a charge could be made in connection with a trade agreement or a non-aggression pact. It is equally obvious, however, that no country would accept a plan which did not provide for some flexibility of rates. The fact that rates can be changed with the consent of three-fourths of the votes (one-half during the first three years) is what causes the difficulty. The likelihood that this restraint will be resented is all the greater because in democratic countries the determination of exchange policy usually is a prerogative of the legislative branch of the government, which the latter has always defended staunchly against encroachment by the executive or the central bank. Quite likely this attitude on the part of legislatures will now be directed against the Fund.

> Clause VII-2 - "Not to engage in exchange dealings with member or non-member countries that will undermine stability of exchange rates established by the Fund."

No definition of the type of transaction referred to is offered. The Fund will therefore have to indicate from case to case what operations it regards as objectionable, which may give rise to controversies. It is possible that the clause is intended to guard against unofficial depreciation, which might occur if members fail to make the official rates effective throughout. In any case the clause seems designed to implement the obligation to maintain the rates established by the Fund, so that the comments made above are pertinent here also.

> Clause VII-3, par. 1 - "To abandon, as soon as the member country decides that conditions permit, all restrictions (other than those involving capital transfers) over foreign exchange transactions with other member countries, and not to impose any additional restrictions (except upon capital transfers) without the approval of the Fund."

The underlined part of the clause is another obligation from which a member can be released by the Fund. In conjuncture with the obligation to maintain stable rates, this clause may become quite onerous because the Fund, by refusing to grant relief from either, can force a member to use up its exchange reserve.

> Clause VII-3, par. 3 - "All member countries agree that all of the local currency holdings of the Fund shall be free from any restrictions as to their use. This provision does not apply to blocked foreign balances acquired by the Fund in accordance with the provisions of V-8, above."

This obligation is unconditional and hence cannot become controversial. It prevents a member from freezing the Fund's assets, which is essential for the Fund's operations. It is not unthinkable, nevertheless, that this clause may cause trouble. The case might arise, for instance, where a country, having exhausted its permissable quota, failed to pay off for a long time. The Fund might then induce other countries to make all their payments to this member through the intermediary of the Fund. This would rapidly reduce the member's debit balance, but would also cut down the member's exchange receipts outside the Fund. If the Fund at the same time refuses further assistance, the member will find itself in considerable difficulties. Under such circumstances, it might decide to freeze the Fund's balances in order to check these tactics. Eventually, the member would probably be expelled, but meanwhile the Fund would be prevented from recovering.

> Clause VII-5 - "Not to enter upon any new bilateral clearing arrangements, nor engage in multiple currency practices, which in the judgment of the Fund would retard the growth of world trade or the international flow of productive capital."

This clause probably is not particularly troublesome, because the pressure to adopt bilateral clearings and multiple currency practices will never be as intense as, for instance, the pressure to depreciate. The Fund may have difficulty, however, to prevent underhanded practices when a member establishes quantitative import restrictions. The latter might easily be employed to canalize trade toward certain countries.

III. Case (c)-"Do" Clauses

> Clause VII-3, par. 1 & 2 - "To abandon, as soon as the member country decides that conditions permit, all restrictions (other than those involving capital transfers) over foreign exchange transactions with other member countries ...
>
> "The Fund may make representations to member countries that conditions are favorable for the abandonment of restrictions over foreign exchange transactions and each member country shall give consideration to such representations."

This clause authorizes the Fund to demand that a country give consideration to its views, but it does not enable the Fund to demand any other action. The country itself is the judge of whether or not conditions warrant the relaxation of controls. In small countries it is possible that the expression of the Fund's opinion will bring heavy pressure to bear upon the government. In a large country, the Fund's voice, as Mr. White said, will merely be one of many factors in the struggle for and against the relaxation of control. If internally the parties are evenly balanced, the Fund may tip the scales; otherwise its representations will remain unavailing. Nevertheless, it must be expected that the Fund's opponents will seize upon the opportunity to attack the Fund for "unwarranted interference."

> Clause V-4 - "When the Fund's holdings of the currency and securities of a member country become excessively small in relation to prospective acquisitions and needs for that currency, the Fund shall render a report to that country. The report shall embody an analysis of the causes of the depletion of the Fund's holdings of that currency, a forecast of the prospective balance of payments in the absence of special measures, and finally, recommendations designed to increase the Fund's holdings of that currency. The representative of the country in question shall be a member of the Fund committee appointed to draft the report. This report shall be sent to all member countries and, if deemed desirable, be made public. Member countries agree that they will give immediate and careful attention to recommendations made by the Fund."

This obligation to give "immediate and careful attention" to the Fund's recommendations is restated and amplified in clause VII-6, which places upon all member countries the obligation:

> "To give consideration to the views of the Fund on any existing or proposed monetary or economic policy, the effect of which would be to bring about sooner or later a serious disequilibrium in the balance of payments of other countries."

The first clause is of particular interest to the United States as the most important prospective active balance country. The "report" which is to be rendered under it is likely to come somewhat later, however, than the expression of the "views" of the Fund referred to in the second clause. The report is to be made only when currency holdings become excessively small, i.e., when a substantial disequilibrium is already noticeable. The "views," on the other hand, would be expressed whenever a policy is maintained or adopted which would "sooner or later" bring about disequilibrium. The very mild pressure which the Fund may be able to exert would thus apparently be applied by stages. First would come the expression of "views" - which might not be directed at the United States alone - and later the more formal report. This seems a desirable arrangement in view of the fact that the Fund's recommendations may have to touch upon internal policies and thus are likely to create somewhat delicate situations. That interests which would be adversely affected by the adoption of the Fund's recommendations would raise the cry of "interference" seems fairly certain, but the Fund may find support on the part of those who stand to gain. Since the Fund cannot demand more than "consideration," i.e., presumably an airing of the matter in Congress, it is obvious that no freedom of policy making is violated by clauses V-4 and VII-6.

> Clauses VII-7 and 8 - "To furnish the Fund with all information it needs for its operations and to furnish such reports as the Fund may require in the form and at the times requested by the Fund."
>
> "To adopt appropriate legislation or decrees to carry out its undertakings to the Fund."

These two clauses are of purely technical significance and should cause no difficulties.

> Clause V-2-c - "When the Fund's holdings of local currency and securities exceed the permissible quota of a country, the Board may require the member country to deposit collateral in accordance with regulations prescribed by the Board."

This demand usually will be coupled with loan transactions, in which case it would fall into category (a). The fund might also decide to ask for collateral after a loan had already been made, but presumably it will not demand anything that the member cannot reasonably be expected to give. No particular problems should arise in this connection.

Foreign Research Division
H. C. W.
September 30, 1943

I N D E X


| | | | |
|---|---|---|---|
| 4/1/43 | - | Memo re legal authority of the United States to fulfill its quota for participa tion in the International Stabilization Fund by transfer of all or part of inactive $1,800,000,000 in gold held in the U.S. Stabilization Fund | 1 |
| 4/3/43 | - | Memo to Mr. Luxford from Minskoff and Brenner re legal authority for the executive branch of the U.S. Government to enter into agreement for purposes of participating in the Fund. | 2 |
| 7/2/43 | - | Memo re: authority of Federal Reserve Banks acting in individual capacity could discount notes, drafts and bills of exchange for the proposed Fund. | 3 |
| 9/15/43 | - | Memorandum re: definition of the word "sovereignty" | 4 |
| 9/25/43 | - | Memorandum re: comprehensive definition of the word "sovereignty" | 5 |
| 10/23/43 | - | Memorandum (with attachment) re: New York Federal Reserve memo on "Sovereignty under the White Plan" | 6 |