C O P Y

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 <u>at any time</u> 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.)