

PRINCETON STUDIES IN INTERNATIONAL FINANCE NO. 41

Exchange-Rate Stabilization in
the Mid-1930s: Negotiating
the Tripartite Agreement

Stephen V. O. Clarke

INTERNATIONAL FINANCE SECTION
DEPARTMENT OF ECONOMICS
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This is the forty-first number in the series PRINCETON STUDIES IN INTERNATIONAL FINANCE, published from time to time by the International Finance Section of the Department of Economics at Princeton University.

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¹ This list, provided for reference purposes, includes only the important posts of the more prominent figures mentioned in this study.

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I. INTRODUCTION

The world depression that began with the New York stock-market crash of October 1929 had many victims. Among them was international monetary cooperation, the offspring of the shared vision of two great central bankers: Benjamin Strong and Montagu Norman. Under the impetus they provided, cooperation between Britain, France, and the United States continued, despite the strains of the deepening slump, reaching a climax with the desperate efforts to deal with the financial crisis that erupted in the summer of 1931. When those efforts failed to prevent sterling from being pushed off gold, however, cooperation suffered a blow from which it did not begin to recover for five fateful years. By the time the first tentative gestures were made under the Tripartite Agreement of September 1936, cooperation among the three democracies had been fundamentally changed in both form and substance.

In a moment of euphoria, the Secretary of the Treasury of the United States, Henry Morgenthau, Jr., saw the Tripartite Agreement as the "greatest move taken for peace in the world since the World War." His history was faulty and his hope fatuous. Although the agreement was a technically useful step toward exchange stabilization, it came too late and was far too limited in scope to stem the international political and economic deterioration. Everywhere, the shattering of the hopes of the 1920s, mounting unemployment, and poverty had loosed pressures on governments to adopt measures that attempted to satisfy national needs at the expense of other countries. The nations that a few years later would form the Axis had already begun to seek remedies through changes in the political order. Japan began its long war in East Asia by the invasion of China. Germany, isolated behind exchange controls, stimulated its economy by rearming, quit the League of Nations, and in March 1936 marched troops into the Rhineland. In October 1935, Italy invaded Ethiopia, and nine months later civil war broke out in Spain. Among the

This study is based primarily on the diaries of Henry Morgenthau, Jr., located at the Roosevelt Library in Hyde Park, N.Y.; the historical records of the Federal Reserve Bank of New York; and U.K. Treasury papers, especially those of Sir Frederick Leith-Ross, Sir Frederick Phillips, and Sir Richard Hopkins, available at the Public Records Office.

In preparing this study, I have received valuable suggestions from numerous individuals, especially Lord Cobbold, Susan Howson, Donald E. Moggridge, Richard S. Sayers, and Allan Sproul. I am of course responsible both for any remaining faults and also for the views expressed, which do not necessarily reflect those of the Federal Reserve Bank of New York. Carl W. Backlund, of the Bank, was most helpful in providing archival material, and I have also benefited from the research assistance of Barry Krissoff, Ydahlia Metzger-Bundy, and Annie McRee.

Western democracies, still weary from sacrifices of the 1914-18 War, these political upheavals were viewed with ambivalence. Hoping that incursions elsewhere would sate the appetites of the dictators, the democracies focused primarily on coping with their domestic economic difficulties. Unfortunately, their policies, too, complicated the problems of others, as tariffs and import quotas were imposed in order to protect shrinking domestic markets from foreign competition.

Inevitably, the disintegration in international political and commercial relations carried over to the monetary sphere. Not only commercial policy, but also exchange-rate policy, was frequently directed to the attainment of what was perceived to be national advantage, while the cost to other countries and possible feedbacks were accorded little importance or ignored. In the cycle of exchange depreciation of the 1930s, the fall of sterling in September 1931 was the first major move.

It is true that the British abandoned gold only when the financial resources available to them were exhausted, and that the subsequent depreciation of sterling was primarily attributable to market pressures. Yet it is also true that the British authorities, while generally offering little resistance to market forces that depreciated sterling, vigorously resisted those that appreciated it, especially in the nine months following the establishment of the Exchange Equalization Account (EEA) in mid-1932. Such resistance was particularly notable between the end of November 1932, when the sterling exchange rate hit its low for the decade, and mid-April 1933, when the dollar was unpegged from gold.¹ During this period, when sterling was under strong upward pressure, British official holdings of gold and foreign exchange increased by more than one-half.² Since a substantial proportion of this reserve gain reflected dollar accumulations in, and gold purchases from, the United States, the American authorities were fully convinced that the EEA, while ostensibly established merely to iron out temporary exchange fluctuations, was actually being employed to preserve as much as possible of the competitive advantage that Britain had gained after September 1931.³

Although the Roosevelt administration's desire to raise U.S. commodity prices was doubtless the major consideration behind its gold policy in the ten months ended January 1934, British exchange operations were

¹ Hall (1938, pp. 149-150). Howson (1976, p. 251) reports, on the basis of her study of official documents, that the British Treasury directed the Bank of England at the end of 1932 to hold sterling at about \$3.30; under strong upward pressure, the peg was raised in stages to \$3.45 in early February 1933. Howson writes that Treasury officials told Norman, at about this time, that for the sake of British industry the pound should not go above \$3.50, even though that would mean absorbing a large flow of dollars and francs.

² *Reserves and Liabilities, 1931 to 1945*, Cmd. 8354, London, H. M. Stationery Office, September 1951, Table 1.

³ Blum (1959, p. 121).

seen as providing a precedent for the depreciation of the dollar. If the reduction in the gold value of sterling could start Britain on the road to recovery, the same medicine might work for the United States.⁴ This logic persuaded Roosevelt to pursue the depreciation until the exchange value of the dollar in terms of sterling had been pushed back to, and even above, the pre-September 1931 parity of \$4.86. Although in the spring of 1933 he toyed with a tripartite arrangement that would have temporarily stabilized sterling at about \$4.00 and the French franc at \$0.0466, the President finally turned against the proposal in a dramatic message that effectively ended the London Economic Conference and that Keynes described as "magnificently right."⁵ Five months later, when increases in the price at which the United States bought gold had driven sterling above \$5.00, the administration again put out very tentative feelers about stabilization. Although details of the scheme changed from day to day, on two features Washington was firm. The French were expected to maintain the franc at the gold value established by the Poincaré government in June 1928, and the percentage devaluation against gold could be no larger for sterling than for the dollar. The administration would try for a sterling-dollar rate of \$5.00 or above; it would accept none lower than the old parity of \$4.86.

The reservations with which the British authorities received this American proposal were not attributable entirely to annoyance over the torpedoing of the stabilization arrangements negotiated in June. In London, there was also skepticism that the French, even if they accepted the proposal, would be able to support the franc at an overvalued level for long. The expected collapse of the franc, along with the other gold-bloc currencies, would again throw the exchange-rate structure into confusion. Most important, the British authorities, whose recollections of the unhappy experiences under the old parity were still fresh, felt strongly that sterling itself would be seriously overvalued at the \$4.86 rate. When, on December 1, Harrison stressed that it would be impossible to get Washington to agree to any temporary arrangement unless the British entered into some commitment regarding the rate at which sterling would ultimately be stabilized, Norman replied that

there was not the slightest chance of getting anything of the sort: in fact, most people [in London], including himself, felt that the dollar was definitely undervalued. If America decided to stabilise at a discount of 40% [in terms of gold] then all his friends in [Britain] would certainly consider that we should stabilise at 40[%] + X.

⁴ Morgenthau's testimony on S-910 before a Subcommittee of the Senate Committee on Banking and Currency, 67th Cong., Mar. 2, 1939, p. 20.

⁵ Clarke (1973, pp. 32-36).

With the rebuff of this stabilization feeler, about the seriousness of which there must be some doubt, the Roosevelt administration proceeded to raise the gold price further, in order, as Morgenthau said, to show the British that "we mean business." The depreciation was ended only when the gold price reached \$35, at which level it was fixed at the end of January 1934.

Uncertainties in the exchange markets were alleviated but far from removed by the dollar's stabilization. The law under which the President had acted provided broad authority further to change the price at which the Treasury bought and sold gold.⁶ The use of this authority was vigorously advocated by various political groups that believed further devaluation would foster domestic recovery. In the mid-1930s, the possibility that such propagandists would catch the President's ear seemed real, and from time to time scares swept the markets that the gold price would again be changed.

British exchange-rate policy also contributed to the uncertainty. Although the Chancellor of the Exchequer, Neville Chamberlain, emphasized the government's intention to minimize unnecessary fluctuations in the exchange value of sterling, the authorities had no power to fix the value of the pound in terms of gold, nor did they feel that such power would be useful in the prevailing circumstances. The international economy, in the British official view, was grossly imbalanced. The exchange rates of the gold-bloc countries were seriously overvalued, while that of the United States was undervalued. Until the disequilibrium was corrected, no stabilization of sterling could be contemplated. In the meantime, it was appropriate, in case of conflict, to give British prosperity and the stabilization of domestic prices priority over the external stability of sterling.

While the markets remained nervous about the external values of both sterling and the dollar, the major source of exchange-rate uncertainty lay in the gold bloc. Conceivably, the overvaluation of the gold currencies would be corrected by deflation on the European continent, assisted perhaps by some inflation in the United States. The greater probability was that the deflation would become politically intolerable and that the international imbalance would be eliminated in the end through devaluation. This outlook, together with the darkening political climate in Europe, induced holders of gold-bloc currencies to shift their funds into sterling and much more into dollars. When the Belgian currency was devalued in March 1935, expectations increased that the French franc and other gold-bloc currencies would soon follow.

⁶ In the Treasury's view, the Gold Reserve Act authorized changes in the gold value of the dollar not only between 50 and 60 per cent of the old value but without limit.

As the likelihood of devaluation increased, the French authorities were confronted with an unprecedented problem. The exchange rates of none of the major currencies could be regarded as fixed. Sterling was floating, even if within a relatively narrow range. The dollar, though pegged to gold at \$35 per ounce, was subject to change. A unilateral devaluation of the franc could bring foreign retaliation in the form of further changes in exchange rates or in commercial policy that would nullify part or all of the French move. Faced with this possibility, the Paris authorities recognized the need for consultations to determine how large a franc devaluation would be acceptable in Washington and London. The era was ended when currencies were viewed as tied to gold rather than to each other. For the first time, international negotiations came into play in arranging an exchange depreciation.

While an orderly transition to a reasonably stable exchange-rate structure was the main objective, the three democracies also had other aims in common. Among these was the desire to minimize the large and sometimes violent international flows of funds that were associated with uncertainty in the exchange markets. Everywhere, such movements complicated domestic economic management, unpredictably aggravating deflation in France and correspondingly expanding liquidity in Britain and the United States. The gold movements that accompanied the capital flows were especially worrisome. In France, large outflows were taken as a sign of no confidence in government policy. In the United States, the authorities were aware that much of the gold inflow reflected movements of refugee and speculative capital that was subject to sudden withdrawal. Were any substantial repatriation of capital to develop during a national election campaign, the results could be politically embarrassing, especially if the voters were to accept opposition contentions that the accompanying gold outflows signified lack of investor confidence in the administration. Moreover, since shifts of such balances were not only a result but a cause of exchange-rate instability, they complicated the attainment of commercial-policy aims and generally increased the difficulties and uncertainties of international trade, whose expansion was required for economic recovery.

In these circumstances, the democracies had no difficulty in agreeing, in principle at least, on the desirability of reasonable exchange stability. The problem in applying this principle was of course that the groups working to safeguard stability frequently had little political clout, while those advocating commercially advantageous exchange rates were strong, vocal, and nationalistic. The tendency, therefore, was for each country to press for exchange rates favorable to itself and to hope that its partners would be able and willing to bear most, if not all, of the burden of adjustment. In this respect, each country's aims were similar, but tactical ad-

vantages were enjoyed by the country that had the initiative in exchange-rate management.

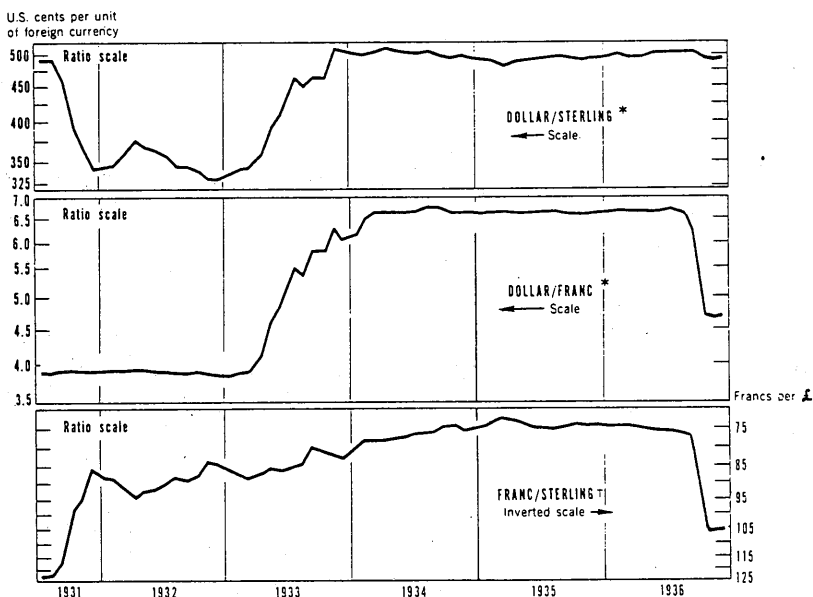
This initiative was held by Britain from the stabilization of the dollar in January 1934 until the conclusion of the Tripartite Agreement, and was made possible by the provisions of the French monetary law of June 1928 under which the Bank of France bought and sold gold without limit at a fixed price. After January 1934, the United States adopted a similar policy, except that it would freely convert dollars into gold only for gold-standard countries like France. Barred from buying gold in the United States, the EEA did not attempt to manage sterling through operations in New York but achieved its aims primarily through operations in francs. If it wished to prevent an appreciation of the pound, francs were bought and converted into gold acquired from the Bank of France. On the other hand, if the British felt that sterling was depreciating unduly, gold could be sold to the Bank of France for francs with which to support the pound. With gold-standard arrangements holding the dollar-franc rate within narrow margins, arbitrage between London, Paris, and New York tended to make movements in the sterling-dollar rate reflect those in the sterling-franc rate (see the accompanying chart).

However, even with the advantage that flexibility provided, Britain's room for maneuver in exchange-rate policy was limited. If, in attempting to serve British commercial interests, the London authorities pushed the depreciation of sterling too far, the task of the French in supporting the Poincaré franc might become intolerably difficult and the Americans might retaliate with a further depreciation of the dollar. On the other hand, attempts by the British to maintain sterling at a level that would significantly ease the task of the French would bring vigorous protests from exporting and import-competing firms in Britain and the other sterling countries. Subject to these constraints, however, the British authorities enjoyed an initiative in the management of exchange rates of which the French and Americans had deprived themselves by the stabilization of their respective currencies.

As a result of arrangements under the Tripartite Agreement, the ability of each of the democracies to manage exchange rates was significantly changed. The advantage the British had enjoyed in handling sterling had to be shared with Paris because France, having abandoned the gold standard, could now manage its currency flexibly between wide gold points. Although Britain obtained convertibility privileges not only in Paris but also in New York, the new arrangements in both quarters were on a tentative basis and involved continuing consultations regarding the management of sterling's rates against the franc and the dollar.

Under these arrangements, the improvement in the tactical position of

BRITISH, FRENCH AND UNITED STATES EXCHANGE RATES 1931-1936



* Monthly averages of daily market buying rates in New York at noon for cable transfers.

† Monthly averages of Saturday spot rates in Paris.

SOURCE: Board of Governors of the Federal Reserve System (1943). Data on franc-sterling rate calculated from figures in Einzig (1937, Appendix I).

France was greater than that of the United States. The Paris authorities gained not only a voice in consultations but, more important, a flexibility in exchange-market operations that derived from the widening of the gold points for the franc. Although the U.S. authorities retained power to change the gold price, they became increasingly wedded to the \$35 price after September 1936. Having regained some of the competitive advantage they had lost after September 1931 and having obtained a voice in the management of the key sterling-dollar rate, the Roosevelt administration was understandably reluctant to expose America's fragile recovery to a new period of exchange instability. So long as changes in the major exchange rates appeared reasonable, no occasion arose to change the U.S. gold price, which came increasingly to be regarded as the foundation of the international monetary structure. The United States thus drifted into the position of the Nth country.

II. CONTROVERSIES OVER STABILIZATION

Defending the Poincaré Franc

In the discussions that preceded the Tripartite Agreement, the French came to accept the necessity for a devaluation of their currency only with extreme reluctance. Until mid-1936, their efforts were primarily directed toward saving the Poincaré franc and, for a time, success seemed within their grasp. Under the influence of severe deflationary measures, the franc actually strengthened during 1934 but only at the cost of falling production and increasing unemployment.¹ In November of that year, a new government, headed by Pierre-Etienne Flandin, came to power with a program that sought both economic recovery and also exchange stabilization. Expansionary measures were to rekindle domestic prosperity, but assurances were needed that the hoped-for recovery would not be undercut by a further depreciation of sterling, whose value in terms of francs had slipped 10 per cent since the end of 1933.

France's effort to enlist cooperation for this purpose failed in both Britain and the United States. In London, the authorities adamantly refused any commitment to stabilize. They held that sterling's recent depreciation was attributable to a decline in Britain's exports to the Continent, which resulted from the tariff, quota, and other defensive measures adopted by France and the other gold-bloc countries. The way to prevent a further fall of the pound was to reverse these policies. When word came that Flandin was anxious to combine a gradual relaxation of such trade restrictions with a simultaneous move for exchange stabilization, the British objected that the combination was illogical. According to Leith-Ross, who discussed the proposal with Rueff,

the difficulties of stabilisation were created by the economic disequilibrium and the first step seemed to me to be to restore such economic conditions as would enable stabilisation to be discussed. So long as America and France pursued their present economic policies, stabilisation was obviously impracticable.

When a visit to London by Flandin in February 1935 failed to obtain assurances of sterling's stabilization, the French turned to the United States in search of support. Disturbed by a further sharp drop in sterling at the end of February, the Bank of France proposed a very large French-U.S. credit to bolster the pound. Speaking for the French central bank, Lacour-Gayet held that the United States, with its immense gold resources, and France, as a leader of the gold bloc, had a special respon-

¹ Sauvy (1967, p. 88).

sibility to cooperate to prevent the disorders that the decline of sterling would inevitably bring about. They were the only two countries, he said, in a position to take the initiative. He was not very hopeful that the British would accept the credit, but, should they refuse, they would definitely be responsible for contributing to the continued uncertainties of the international currency situation and the consequences it might have. Lacour-Gayet predicted that if the gold bloc collapsed an international race in currency depreciation would ensue.

Lacour-Gayet's eloquence failed to overcome the American government's reluctance to undertake any initiative toward Britain. At least partially aware of their ignorance of the technical aspects of international finance, Roosevelt and Morgenthau felt at a disadvantage when confronted by British negotiators, whose familiarity with international monetary affairs was proverbial. "When you sit around the table with a Britisher," Roosevelt told Morgenthau in April 1936, "he usually gets 80 percent out of the deal and you get what is left." They were doubly uneasy because, having led the major powers to the brink of exchange stabilization in mid-1933, Roosevelt had scuttled the London conference with his famous bombshell. "The English," Morgenthau noted in his diary, "definitely feel that [Roosevelt] double-crossed them in the summer of 1933 and that is why they have acted so peculiarly about stabilization ever since." In response to Morgenthau's efforts to obtain the President's approval for the opening of discussions with the British, Roosevelt remarked that "as long as Neville Chamberlain is there we must recognize that fundamentally he thoroughly dislikes Americans." Morgenthau followed this with his own observation that "the President, of course, himself thoroughly distrusts the British and I think in his heart is a little bit afraid to talk to them for fear that they will get the best of the bargain."

With these feelings prevailing in the White House, Lacour-Gayet's efforts were fruitless. Speaking for the Roosevelt administration, Morgenthau expressed sympathy for the French objective but noted that the Bank of England had not requested the credit and would probably reject it. The proposed approach to the British was therefore regarded as likely to be both futile and embarrassing.²

The making of this proposal was the last occasion on which the French were in a position to lead from external strength in supporting the gold bloc. The appreciation of the franc on the exchanges was accompanied during March by a rise in France's gold reserves to a peak of nearly \$5.5

² Morgenthau's hunch about the British attitude was doubtless correct. Sir Frederick Phillips suggested in May 1935 that a director of the Bank of England who was then visiting America should "repel any suggestion that we are contemplating stabilisation buttressed up by short term credits from the principal gold holding countries."

billion. Thereafter, the tide turned swiftly. The defection of Belgium from the gold standard at the end of March was seen by the exchange markets as fatal to the rest of the gold bloc. Speculative pressures swung against the Netherlands, Switzerland, and France. In the two months ended May 30, 1935, the Bank of France showed a gold loss of \$720 million.

Even so, the French authorities remained fully committed to the Poincaré franc. With the French economy in deep depression, the Bank of France increased its discount rate toward the end of May to 6 per cent from the 2½ per cent that had been normal since late 1931. Nevertheless, the fall of the Flandin government on May 31 precipitated a tremendous rush into dollars and, to a lesser extent, into sterling. As was its normal practice, the EEA supplied the sterling for francs, which were promptly converted into gold. However, no similar official arrangement was in place to supplement the supply of dollars which, in ordinary circumstances, were provided through the private market. Since there were fears that the amount of gold sold by the Bank of France would become too large for private channels to handle, a supply of dollars adequate to support the franc could be obtained only through special arrangements under which the U.S. Treasury agreed to earmark \$150 million of gold in Paris.

Backed by the balances provided by the U.S. Treasury, Cariguel related that he faced the foreign-exchange market on May 31 feeling as if he had just won the grand lottery, told stories, joked with the traders, especially the well-known speculators, loafed throughout the session, and successfully put over the impression of a man who did not have a worry in the world. Although he sold only \$34 million, he insisted that it was only by his bold intervention, offering dollars promptly and fully to every customer, that the mad rush was broken. Had not the right impression been created from the start, he said, the speculators would have swept past, and a depreciated franc would have been the result.

The Bank of France's stand, together with the formation by Pierre Laval of a government pledged to defend the franc, ended the immediate crisis. Until the close of the year, French gold reserves recouped some of their earlier losses and the discount rate was reduced in several steps to 3 per cent. A skirmish had been won in the exchange markets, but France's domestic economy continued to stagnate. The basis for the Poincaré franc was eroding as political tides swung toward the coalition of the left that Léon Blum was to lead to power in the spring of 1936.

The United States Edges toward Stabilization

As France moved toward devaluation, the Roosevelt administration was loath to do more than provide sympathy and dollars against gold. Ac-

tion that might have helped—remission of war debts and, more important, the initiation of discussions about exchange stabilization—were found unpalatable by the administration. As already noted, fear of being outwitted or snubbed by the British played a large part in the administration's attitude, but domestic politics and bureaucratic and personal influences were also important.

Much of the basis of Roosevelt's power, as the 1936 election approached, lay in the agricultural and raw-material-producing hinterland of America that had benefited from the rise in commodity prices accompanying the dollar's devaluation. Although the magic of increasing the gold price had worn thin, the possibility that the President might use his authority further to devalue the dollar was helpful in fending off mandatory inflationary proposals that were continually being introduced in the populist-dominated Congress. By the same token, the administration was loath to be seen considering exchange-stabilization proposals, especially those that were associated with the gold standard, deflation, and the internationally oriented banking interests of New York.

Yet the case for stabilization was strong. After a European trip, Jacob Viner advised Morgenthau that exchange instability was checking world recovery.³ Viner's view was supported and elaborated in a paper prepared for the State Department in March 1935 by Alvin Hansen.⁴ He argued that international disequilibrium and foreign-exchange disturbances were impeding world economic recovery by (1) undermining confidence and thus discouraging an expansion of fixed investment, (2) stimulating the imposition of quotas and exchange controls that were depressing international trade, and (3) causing further deflation in the countries of the gold bloc. These obstacles to recovery, Hansen believed, could be eliminated by a stabilization program based on a 20 to 25 per cent devaluation of the French franc and a sterling rate within the range of \$4.50 to \$4.86.

These arguments were echoed at the Federal Reserve Bank of New York and were supplemented by others of a shorter-term tactical nature. Early in March, a few days before the Bank of France proposed the joint credit to support sterling, Harrison attempted to jolt the Treasury into taking a more active hand in managing exchange markets. Telephoning T. J. Coolidge, the Undersecretary of the Treasury, Harrison said that a continued drop in sterling would unavoidably force further deflation on the gold bloc. Summarizing this conversation with Coolidge, Harrison noted that the administration had been very much concerned earlier in

³ Blum (1959, p. 131).

⁴ Hansen's paper was sent to T. J. Coolidge of the Treasury by Undersecretary of State William Phillips on April 15, 1935.

the year about the possibility that an adverse decision by the Supreme Court in the gold-clause cases would result in an appreciation of the dollar in the exchange markets,

their argument being that we would lose all the advantage that we had got by devaluation; that it would be depressing on the prices of export raw materials and generally deflationary. If, and to the extent that, this is true, it is certain that deflation of other currencies abroad would have approximately the same effect on export prices as revaluation here would have had, for in either case we would lose whatever advantage there is in the low price of the dollar in relation to other currencies. I emphasized as vigorously as I could that it was incomprehensible to me that the administration could be so alarmed about the deflationary effect of revaluing the dollar and so complacent about the possibility of a rise in the relative value of the dollar through depreciation of other currencies. It . . . was a selfish policy to sit back and watch the other currencies go to pieces without taking any steps either to correct the situation or to find out what was the policy of other nations in the matter.

In particular, Harrison "thought it inexcusable for the two great English speaking nations to sit back without consulting one another at this critical time." In reply, Coolidge expressed sympathy with Harrison's concern and said he would relay his views to Morgenthau. Later in the day, Coolidge called back to say that both the President and Morgenthau were determined not to take the initiative in discussions with the British and that there was nothing to do for the moment but "sit tight."

With the desperate conditions of 1932-33 still fresh in their minds, Roosevelt and Morgenthau were understandably worried about any international monetary proposals that would limit their freedom in domestic policy. Policy proposals originating in the New York banking community—associated with the orthodoxy of the gold standard—carried little weight. Roosevelt was so sensitive that when he read Hansen's stabilization proposal he became terribly angry and told Morgenthau "that the man should absolutely be fired." Morgenthau, himself, thought the study "one of the most stupid and anti-New Deal memoranda that I have seen in a long time."

Although Roosevelt and Morgenthau had no very clear idea, at this stage, about the nature of the international monetary system that should replace the gold standard, they were certain that they and nobody else should guide U.S. efforts toward the rebuilding. For this purpose, Roosevelt had directed that international monetary questions generally, and exchange stabilization particularly, were to be under the jurisdiction of the Treasury rather than of the State Department, which he regarded as being excessively influenced by J. P. Morgan. Indeed, much of the wrath aroused by Hansen's proposal—a proposal which, in retrospect,

appears quite reasonable—almost certainly reflected Morgenthau's feeling that the State Department was poaching on his bureaucratic preserve. For the same reason, Harrison's policy proposals in the international monetary area fell on deaf ears, although Morgenthau did rely heavily on the New York Reserve Bank for technical assistance and advice on the management of the exchange markets.

Indeed, abysmal ignorance of the working of exchange markets was another obstacle to international monetary cooperation. When the French government crisis toward the end of May 1935 was threatening to create severe pressures against the franc, Morgenthau was willing enough to supply dollars against gold but suggested, in response to the Bank of France's request for \$200 million, that \$50 million be provided by the British. Despite attempts to explain to him that the EEA was already vigorously supporting the French franc and that the French needed dollars, not sterling, Morgenthau insisted that the Bank of France approach the British about providing a share of the arrangement. When Tannery refused to approach the British on this question, because to do so would have been ridiculous, Morgenthau agreed to provide only \$150 million, which, as already noted, fortunately turned out to be more than adequate to break the speculative attack. Even a year later, Morgenthau was still having trouble with foreign-exchange jargon. Telephoning from Paris on May 1, 1936, during the parliamentary elections that brought Blum to power, Merle Cochran, Financial Secretary of the U.S. Embassy in Paris, reported to Morgenthau that French interests were selling francs and moving, to some extent, into dollars but mostly into sterling. The dialogue continued:

- C: And so the pressure is rather strong today.
HMjr: There's a what?
C: The pressure—
HMjr: Yes.
C: The pressure on the franc is bad.
HMjr: I don't get that.
C: I say, the franc is weak.
HMjr: The franc is weak?
C: Yes, the pressure on the franc is—is heavy.
HMjr: I'm sorry, I don't get it.
C: Well, the franc is weak, that I said [*sic*].
HMjr: The what?
C: There are many people who want to sell their francs.
HMjr: Yes.
C: So it is weak as a result.
HMjr: I don't get that.

- C: Well, you do have it that they want to sell their francs?
HMjr: Yes.
C: Well, that's the point.
HMjr: I see, all right.
C: They are afraid.
HMjr: I see. Now,—anything new on the political situation?

Despite these obstacles, the Roosevelt administration was pushed toward discussions with Britain. The possibility that exchange instability was impeding economic recovery—which had concerned Viner, Hansen, and others—was especially worrisome. The weakness of sterling in February-March 1935, the subsequent Belgian devaluation, and the renewed pressures on the French franc stimulated not only urgent warnings from Harrison but also some rethinking in Washington. Yet discussions were slow in starting. A tentative approach by Undersecretary of State William Phillips in mid-March 1935 proved fruitless, both because he was infringing on Morgenthau's bureaucratic preserve and because the British were totally unreceptive.

In early April, Morgenthau himself made a move. He told Jay Crane that "if we can stabilize our currency with the French, the British will have to come to us." In subsequent discussions with the French Ambassador, de Laboulaye, the Secretary said that he wished to stabilize on the basis of existing exchange rates among the three countries; a range for sterling of 10 cents on either side of \$4.85 would be satisfactory. Such a move by France and the United States—which together owned 70 per cent of the world's gold—would, the Ambassador agreed, put the British in a very strange position; they would "have to do something." Why was not explained, and in fact these discussions brought no response from the tottering Flandin government.

At the beginning of May 1935, Morgenthau and a director of the Bank of England, Sir Josiah Stamp, had an opportunity to sound each other out when Stamp visited the United States. Both disclaimed any feeling that exchange stabilization was urgent. Writing to Hopkins, Stamp reported Morgenthau's view that when steps were required toward stabilization, "two days could fix it up." The Secretary suggested that, when the occasion did arise, a private meeting on neutral ground in Canada could easily be arranged. He emphasized that the subject could be handled only by himself or the President. Stamp understood this to imply that central banks would not figure in any stabilization discussions. Morgenthau also emphasized the closeness and cordiality of his relations with the French authorities. According to Stamp's report, Morgenthau "rapped into me good and hard that the exchange of information with France was most satisfactory to both sides, and that both France and themselves consid-

ered our attitude stand-offish." Despite Morgenthau's appearance of complacency about Anglo-American exchange relations, Stamp concluded that the Secretary "was *really anxious* that contact should be resumed without giving himself *away in the slightest* in asking for it."

At about the same time that Stamp was in the United States, Harry White, who had been brought to the U. S. Treasury by Viner, was touring Europe in order to study financial conditions. Visiting London, he discussed the likelihood of devaluation by the gold bloc. As reported by Leith-Ross, White held that if the gold countries acted

under pressure of events, they would almost certainly devalue too much and create new maladjustments. If, on the other hand, we would join in some general arrangement, they would be ready to keep their devaluation to very moderate dimensions. In these circumstances, it seemed to him that, as practical people, we had every interest in promoting such a general arrangement. We would thus be able to retain a great deal of the competitive advantage that we had got from the depreciation of sterling: while if we waited and the European countries devalued, we would lose that advantage. He did not suggest that we should definitely stabilise, but that we should adopt a de facto stabilisation.

White's views were far ahead of those his chief was willing to express in public. The United States, said Morgenthau in a radio broadcast of mid-May 1935, was unwilling to relinquish the authority to change the gold price; to do so would provide a temptation to other countries to take advantage of our self-imposed rigidity. On the other hand, when the world was "ready to seek foreign exchange stabilization," the Roosevelt administration would not be an obstacle, provided the United States was not asked to "lose what we have just regained." Morgenthau concluded on a strong nationalistic note:

We are not unwilling to stabilize. However, if the great trading nations elect to continue under the present absence of rules we are no longer at a disadvantage. We revalued our currency no more than was necessary and we can go either way. Our hands are untied.

Not surprisingly, Morgenthau's speech did nothing to lure the reluctant British into stabilization discussions.⁵ As the year drew to a close, Morgenthau was still complaining to Bewley of what he regarded as the uncooperativeness of the British Treasury. When Bewley defended his government, Morgenthau said that the first basis for cooperation is the exchange of information. Although the United States had fully informed the Bank of England about its sterling operations, Morgenthau had no direct channel with London to provide him with information about the op-

⁵ See Sir Frederick Phillips's May 16, 1935, comment on Morgenthau's broadcast, quoted below.

eration of the EEA. For such information, he had to rely upon his sources at the Bank of France. What we are trying to do, Morgenthau concluded, is

to stabilize a three-point situation, which is London, Paris and New York, and the very basis of that is the exchange of information. I never would ask for it, because I did not want to be rebuffed. Having you here, I thought I would talk to you about it.

As always, Bewley was sympathetic, but his report fell on deaf ears in London. Not until the following spring, when the Left's election victory triggered heavy pressure against the franc and the long-expected devaluation crisis seemed imminent, did yet another feeler from Morgenthau finally elicit a positive response from Chamberlain.

British Resistance to Exchange-Rate Commitments

While France was fighting a losing battle to maintain the Poincaré franc and Morgenthau attempted to start an international monetary dialogue with Neville Chamberlain, the British authorities played a waiting game. During 1934, recovery lost momentum in Britain as well as in the United States. Although Britain was gaining gold and real per capita income was at record levels, exports were far below those of 1929 and one-sixth of the labor force was still unemployed. The opinion was widespread that, with the slower rise in domestic spending, new impetus for recovery would have to come from abroad. However, the needed rise in foreign demand could come only after an orderly depreciation of the gold-bloc currencies had set the stage for economic recovery on the Continent and the quotas and other trade restrictions that hampered the growth of British exports had been dismantled.⁶

Such views were widely accepted by private British commentators and found expression in confidential memoranda that circulated among the London authorities. Nevertheless, British officials were bound to refrain from public expression of views that contradicted the announced position of the French government on so emotionally charged an issue. Indeed, throughout much of 1934 the EEA acted, frequently with some vigor, to prevent sterling from dropping to a level that would further complicate the problems of the franc.

However, around the beginning of September 1934, the British authorities, loath to accept further substantial gold losses, abandoned the 76¼ at which they had been pegging the franc rate. Thereafter, the EEA recouped some of its earlier gold losses and sterling gradually depreciated. Concern grew that pressure on the gold bloc would become intolerable.

⁶ Robbins (1935) and Keynes (1935).

erable and that its currencies would be heavily devalued, precipitating a round of competitive depreciation that would block the recovery of international trade. Such worries, together with Flandin's visit to London and the pronounced weakness of the pound early in 1935, stimulated intensified discussions of exchange stabilization. Nevertheless, Neville Chamberlain scotched such talk on March 7 when he told Parliament that stabilization "is clearly impossible [because the franc and the dollar] are out of economic relation to one another." Were sterling fixed on gold in these circumstances, Britain would be exposed to policy changes in France or the United States that might force an increase in the Bank of England's discount rate, restriction of enterprise, and increased unemployment. Britain was not "in a position . . . to take these risks," and he, as Chancellor, refused "to put the pound at the mercy either of the franc . . . or of the dollar. . . ."⁷

Chamberlain's views were based, of course, on bitter experience. Only ten years earlier, Britain had returned to the 1914 gold parity of sterling without giving much thought to the parities at which its Continental competitors would stabilize. In the light of the consequences, that return was regarded as a tragic error. Anxious to avoid a repetition of past mistakes, the British authorities of the mid-1930s were keenly aware that Roosevelt retained authority further to reduce the gold content of the dollar and that the French could not be expected to maintain their parity for long. To stabilize sterling in the face of these uncertainties would be to repeat the folly of 1925.

Accordingly, the British authorities took the view that they could only wait until adjustment abroad had restored a semblance of balance in the international economy. In the meantime, they should avoid exchange commitments. Even international consultations were discouraged. In mid-May 1935, when the franc was still under pressure from the effects of the Belgian devaluation, Mönick warned Leith-Ross that the devaluationists were gaining ground in France. The devaluation, when it came, would certainly not be less than 20 per cent and could even exceed 30 per cent, because France would need to allow for a further depreciation of sterling. Mönick believed the higher figure was excessive. According to Leith-Ross's account, Mönick stated that

it would undoubtedly help the French Government to maintain a reasonable policy if they could have some knowledge of our intentions . . . if we simply refused to enter into discussions and left them to guess at our intentions, the feeling in France would be that sterling was bound to depreciate further and that it was a hopeless struggle to try and maintain the franc. From this point of

⁷ House of Commons, *Debates*, 298 (Mar. 7, 1935), cols. 2261-2262.

view he was most anxious if possible to obtain any information which he could give to Paris as to the possibility of our entering into some arrangement for pegging sterling on the dollar at a suitable rate and for preparing a programme looking towards stabilisation when the conditions were ripe.

I told M. Mönick frankly that . . . the view here was very definitely that any such discussion would only lead to misunderstandings which it would be well to avoid. We could not offer advice to France and we were not likely to accept advice from France. I told M. Mönick that I would report what he had said but that I did not expect that it would alter this opinion.

Signs that the Roosevelt administration might be interested in stabilization discussions were treated with derision by the British authorities. The dollar had been heavily devalued at a time when the U.S. balance of payments on current account was in surplus, albeit a small one. The surplus had almost tripled in 1934. Furthermore, capital had moved to the United States, aggravating the imbalance. America had consequently absorbed more than \$1 billion in gold, exceeding the world's production for the entire year. With heavy gold movements to the United States continuing in 1935, the British authorities saw no early prospect that the international disequilibrium would soon be corrected. Eventually, the inflationary effects that were expected to result from the New Deal policies might push American prices into better alignment with those abroad. Until that time arrived, discussions of exchange stabilization with the United States would be fruitless and only give rise to misunderstanding.

It was with such views in mind that the London authorities assessed Morgenthau's May 13, 1935, radio address on U.S. international monetary policy. The speech was regarded as cleverly self-serving. Analyzing the address for the Prime Minister, Sir Frederick Phillips found Morgenthau's attitude

reactionary, far more reactionary than the attitude of the American Delegates at the London Conference. America must continue to have her "normal share" of world trade: if that results in a highly favourable trade balance, well, the rest of the world must settle up the difference by sending her monetary metals. . . .

There is no acknowledgement or admission that by continuing to mask itself in the trappings suitable to a debtor nation the United States with its tariff policy, its monetary policy and its refusal to take steps to adjust an excessively favourable balance of payments, is itself now the principal obstacle to world stabilisation.

For his part, Leith-Ross doubted whether Morgenthau had intended to make a serious offer to discuss stabilization. The forces favoring further inflationary measures were still very strong in the United States. Although Leith-Ross believed that Roosevelt had no desire to devalue

further, he thought the President would find it difficult politically to give up his authority to change the gold value of the dollar. Morgenthau put forward his offer in order to help restore confidence in the dollar, but with the expectation that it would be rejected by the British. Roosevelt, Leith-Ross concluded, "would keep his hands free but would be able to throw the blame for the continued instability of the world on to the United Kingdom."

This generally negative reaction to both American and French feelers led some British officials to question whether their government's stance was not altogether too stand-offish. Shortly after he had delivered the response to William Phillips's stabilization feeler of mid-March, Sir Ronald Lindsay wrote to Leith-Ross that he was unhappy because he had "long had the impression that you in London wish actually to avoid conversations with the United States. . . ." Lindsay admitted that he was not sure that anything would bring the Roosevelt administration to act wisely:

Such communication as we have to make to America about stabilisation ought to be couched in words of one syllable and written with insulting clarity. But I fear that the impression created on them by the communication now made will be that of a snub. With its smooth well turned phrases it has in it about as much sympathy as a billiard ball. I shall be surprised now if we hear anything further from Washington about stabilisation for many a long day. Surely this is regrettable for it seems to me that so far as concerns all questions of external obligations between nations America's position is and must continue to be one of overwhelming strength.

To break the barrier between the two countries, Lindsay suggested that the British and American stabilization funds should begin informing each other about their operations. This or some other similar move would help to remove the widespread American suspicion that Britain was managing the exchanges in order to secure competitive advantage.

White's visit in May 1935 also stimulated British officials to question whether some cautious discussions might not be advantageous. They heard through Mönick that White had indicated that the U.S. Treasury did not regard the old \$4.86 parity as essential but would view \$4.60 as a reasonable level at which the sterling-dollar rate might be pegged. Fifteen months earlier, Sir Frederick Phillips had calculated that the equilibrium level for this rate was probably in the \$4.50 to \$4.60 range. Learning of White's remarks to Mönick, Phillips showed a flicker of interest. To be sure, he doubted that any importance should be attached to White's suggestion since the American had disclaimed any authority to negotiate. However, in view of the danger of a disorderly devaluation of the franc, he was moved to calculate that the \$4.60 rate implied that sterling would be worth 87½ francs if France devalued 20 per cent and 100 francs if the

devaluation were 30 per cent. Feeling apparently that this was a range of exchange rates that Britain could live with, Phillips thought that there might be some advantage in keeping in touch with the French. In doing so, the British would need to reiterate the difficulties of stabilization under the existing circumstances and to stress that Britain was determined to sustain its domestic economic recovery by following a "liberal and consistent monetary policy." Recovery could

not stand the shocks caused by alterations of credit policy necessitated by difficulties connected with foreign exchange. If for instance we had tried to meet the weakness of the pound in February by contracting credit, the blow to recovery here would have been disastrous. By pursuing our credit policy unchanged, we got over that hurdle.

Assuming that the French could be made to realize all of the difficulties, it might be appropriate to discuss privately what would be a reasonable sterling-franc exchange rate. Having mentioned the idea, Sir Frederick Phillips immediately began to back away. There could, of course, be no commitments and there was the danger of leaks. The French are "pretty desperate." If they continued to harp on an immediate stabilization of sterling, "we should have to back out at once. . . ."

A few days later, Sir Warren Fisher suggested that the handling of recent American feelers "may well have left on the minds of the United States authorities the impression that our attitude was not only negative but unhelpful." Steps to counter this impression could, he felt, be useful. The prospect of stabilization discussions with foreign countries could help the Roosevelt administration to resist the "clamour of the inflationists." Such discussions might also have an educational effect on the administration, which "appears to lack expert and orthodox guidance in international finance." He granted that persuading the New Deal to change its policies might be difficult but argued that he could "see nothing but advantage in telling the Americans, when they begin to agitate for stabilisation, what it is in their present policies which we consider to be incompatible with early stabilisation."

Fisher's proposal was supported by Leith-Ross, who (like Lindsay) suggested that a useful starting point might be an exchange of information on the operations of the British and the U.S. stabilization funds. Such information had a crucial bearing on stabilization discussions. Leith-Ross was especially curious to learn whether the U.S. fund had made significant purchases of sterling. If so, the information would justify British arguments that, as a preliminary to stabilization, the sterling-dollar rate should be allowed to find its own level, even though the expected depreciation of the pound would increase the pressure on the gold bloc.

Leith-Ross went on to stress the point that as long as Britain's employment situation was not substantially improved, any stabilization arrangement would need to be tentative. "Thus, if . . . we found that we lost any considerable quantity of gold, we must be free to reduce the exchange rate (instead of increasing the bank rate) and to repeat the process till equilibrium is restored."

This flurry of activity received a setback early in June 1935, presumably because Chamberlain remained unmoved in his opinion that any response to the feelers from abroad would be counterproductive. Atherton, the American Financial Attaché in London, who had been privately discussing an exchange of information about stabilization-fund operations, was told that nothing would be forthcoming from the British side and that the London authorities could therefore expect nothing from America. Atherton was asked to wash out the conversations which he and the American Ambassador had had with British officials and "not to report them to Washington at all."

III. THE OPENING OF EXCHANGE-RATE NEGOTIATIONS

With the election victory of Léon Blum's Front Populaire at the end of April 1936, speculative pressures against the franc increased sharply. Blum came to power with a program that promised domestic economic recovery without devaluation of the franc. Deflationary policies would be reversed, public works would reduce unemployment, the banking system and heavy industries would be brought under government control, wages would be determined by collective bargaining, the work week would be shortened to forty hours with no cut in earnings, and labor would have paid holidays.¹ Impatient to reap these gains, unionized employees staged "sit down" strikes during which factories were occupied. Fear of civil strife, always latent in France, became an active preoccupation. Capital outflows accelerated. The Bank of France's gold reserves, which had dropped only slightly since the beginning of the year, fell \$242 million in April and \$326 million in May. The central bank's discount rate was increased to 5 per cent on March 28 and to 6 per cent on May 6. Telephoning from London, George Bolton told Knoke that the attack on the franc was the most severe he had yet seen. Toward the end of May, Knoke questioned whether the French gold reserve had not reached the \$3.5 billion minimum that the Paris authorities would wish to hold as a war chest.

In Washington, Morgenthau sensed that the long-awaited French devaluation crisis was near. As he saw it, the need was for an orderly change in the exchange-rate structure—a tripartite agreement under which the French would be assured that, if they devalued a reasonable amount, the United States and Britain would stay put. But in order to obtain permission from the President to negotiate such an arrangement, Morgenthau had to overcome Roosevelt's strongly held belief that, as regards stabilization questions, the first move should come not from the United States but from the British. Meeting on April 29, Morgenthau reminded the President that "... you can trust me . . . to hold up my end of the argument. . . . It is perfectly silly for two countries to be doing business together in the dark with a big wall between us. . . . I want to open a channel of communication. I think it is very important." Finally, after much discussion, Roosevelt reluctantly authorized Morgenthau to undertake a modest initiative. He could ask Bewley for background information about a small gold purchase that had been made in London by the Bank of England

¹ Sauvy (1967, pp. 182-205).

under a standing order from the U.S. Treasury and also give Bewley a "little talk" about the wall between the two countries.

Morgenthau lost no time. He saw Bewley the same morning that he talked with the President and again a few days later at a dinner party. Although the Secretary apparently went no further than his authority from the President permitted, Bewley got the unspoken message. Writing to S. D. Waley of the British Treasury, he observed that the U.S. authorities were

expecting France to go off gold before long, that they are afraid this may be followed by a new period of currency unsettlement, that they do not themselves at all want to devalue the dollar further, but that they do not know British intentions and are somewhat nervous that if sterling were to follow the franc any distance an outcry for corresponding dollar depreciation would be raised here, and that they would accordingly be glad of information or of any measure of cooperation which they can get from His Majesty's Government (meaning I suppose in practice that they are anxious for the pound to be held as steady as possible and would welcome any statement or action that can be made or taken to this end).

Despite Bewley's efforts, Britain's initial response to Morgenthau's feeler was disappointing. In London, no special significance was attached to Morgenthau's question about the gold purchase. After a silence of almost three weeks, Bewley apologetically brought the unhelpful response from the British Treasury that the gold had come "on the market in the ordinary way and they bought it." Morgenthau was greatly annoyed. The information—such as it was—was so slow in coming as to be useless. He had made two or three gestures toward opening a channel of communication with the British but had gotten no place; he would not make another attempt; the next move would have to come from the Chancellor of the Exchequer:

If we were at war with each other we could not be acting any differently. . . . There is no reason in the world why our objective should not be the same and no reason why we should be clashing in the world's money market. The common enemy that we all have is the speculator that knows no flag. I have gone as far as the dignity of my position will permit me to go.

Bewley's report of this interview finally brought a positive response from London, although another two weeks passed before it was delivered to Morgenthau. On June 1, 1936, Bewley presented the Secretary with two messages. One was a personal letter from Neville Chamberlain in which the Chancellor expressed the desire for "closest and most friendly contact" between the United States and British Treasuries.² The other,

² Blum (1959, p. 143).

more formal message outlined the views of the British government. After reviewing Britain's established economic policies, this message indicated that if the gold bloc were forced to devalue, the British government would hope that sterling "would continue to be held steady in terms of gold irrespective of what the French franc does." Assuming that the gold value of the dollar were likewise steady, "the parity between the pound and the dollar would remain unaltered." This pledge was qualified by the reservations that the government's economic policy would be subject to review in the event that Britain's economy was adversely affected either by a big drop in commodity prices or by violent reflux of the large amount of French money that had moved abroad.

Interpreting this message at a meeting with the Secretary on the following day, Viner said that the British

tell you that in the absence of unforeseen circumstances such as a tremendous run for cover to gold or a tremendous run of French funds back to France, which would involve them if they took no action, that they are satisfied even in the face of a devaluation by the gold bloc both with the relationship between sterling and gold and sterling and the dollar. There is nothing better that you could ask for.

Sterling was then being quoted at \$4.99 to \$5.00; the British, it seemed, were accepting that rate as satisfactory. Morgenthau was elated. Not only would the proposed cooperative arrangements alleviate Europe's monetary difficulties but—with the U.S. national elections only five months off—they would be a stimulus to American business.

Viner then reminded the Secretary that the full value of the newly established Anglo-American understanding could be realized only by disclosing its substance to the new French government—"they will feel they have solid ground to jump into." Morgenthau agreed but observed that he would first need to obtain the approval of the President, who was unaware that discussions had gone beyond opening a channel of communications.

When he approached Roosevelt on June 3, Morgenthau obtained the President's approval for a cordial letter to Neville Chamberlain but found him difficult to pin down regarding the details of the joint message to the French.³ Finally, on the morning of June 4, as exchange-market conditions continued to deteriorate, Morgenthau felt the administration was missing its opportunity. He telephoned the President and, after describing the increased pressure on the franc, said he wished to assure the French that, unless something unforeseen happened,

³ *Ibid.*, pp. 144-145.

Great Britain and the United States would not devalue further if the French devalued 20 to 25 %. If I can do that now and get that to Blum over the weekend, he might be able to save his country. To sit here until the catastrophe blows up in our face, I think is stupid.

Having extracted approval from the President, Morgenthau informed Bewley of the administration's position but widened the devaluation range that would be regarded as acceptable to 20 to 30 per cent. Since Blum was expected to present his Cabinet to Parliament on June 6, at which time the decision to devalue might well be announced, any Anglo-American assurances had to reach Paris quickly. Expanding, Morgenthau told Bewley that the joint move was the "horse sense, sensible thing to do"; the benefit to the United States would be "general world stabilization of currencies" from which we would "get our share" of the expected increase in world trade.

Much to Morgenthau's annoyance, neither France nor Britain was ready to act. The new Blum government was deeply concerned about the reaction of the French public; any devaluation had to be cloaked in a form that the French people would accept. Consequently, Morgenthau's straightforward proposal horrified Vincent Auriol, the Minister of Finance, who countered with a scheme that must rank as one of the masterpieces of international monetary obfuscation. He would suggest to his government a multilateral arrangement envisaging a leveling out of currencies in accordance with some common measure such as world prices. The arrangement would be negotiated among not only the big three but the other gold-bloc countries. Exchange rates established under the arrangement could not be altered subsequently except with the consent of the other parties. The United States should take the lead in negotiating with the other countries and France should not be singled out. Auriol, himself, could not "approach the British, or be quoted as even personally favoring or suggesting or inspiring any devaluation scheme. . . . He would have to withdraw from the Cabinet if any leak involving his position . . . should develop."⁴

His hopes of early action deflated, Morgenthau attempted to carry out Auriol's suggestion. He instructed Cochran, who was going to Basel for a meeting of the Bank for International Settlements, to sound out the representatives of Holland and Switzerland about the French proposal. Providing a full account of developments, Morgenthau also told Bewley that "the French seem to think it is hopeless to get together with [the British]."

⁴ Telegram No. 467 from Merle Cochran to the Secretary of State, June 6, 1936, *Foreign Relations of the United States, 1936*, Vol. 1, pp. 535-536.

Ostensibly, the obstacle in London was procedural. Conveying the substance of a telegram from his government, Bewley told Morgenthau on June 8 that although the British agreed by and large with the United States, there had been no communication between London and Paris on monetary policy since the Blum government came in. So far as the British knew, the French still hoped to maintain their gold parity. Accordingly, the Chancellor wished to avoid any move that "might possibly be represented as trying to push them off gold." Chamberlain, Bewley continued, was doubtful that the French would welcome any such approach,

unless possibly for the reason that it would help them to shift the responsibility on to other shoulders, which clearly would be embarrassing to all concerned and his [i.e., Chamberlain's] conclusion, therefore, is that he is rather reluctant to take the initiative himself at present, but if the French should approach you [i.e., Morgenthau] in any way, he would be perfectly willing to discuss the position with them.

While the silence between Chamberlain and Auriol remained unbroken, negotiations in Basel proceeded smoothly. The Dutch and Swiss showed interest in an arrangement under which they could devalue 20 to 25 per cent while sterling and the dollar remained steady.⁵ For their part, the British had told Morgenthau that a French devaluation of 15 to 20 per cent would be reasonable, with 25 per cent the maximum. After reviewing the matter with his staff, Morgenthau fully agreed with these figures. Given the wide extent of agreement, Morgenthau was impatient about the diplomatic impasse between London and Paris. He told Bewley:

Here you and I know that the situation is—the cherries are ripe. . . . If we could get the Dutch and Swiss to agree, could you not do this: could you not ask the Chancellor for a suggestion what the next move is now, knowing that the Swiss and the Dutch are willing? . . . This thing is so important that we must not let the thing drop because we don't know who is to talk first.

Bewley agreed to raise this question with his government and then went on to underline a qualification that both he and Morgenthau took for granted, i.e., that, whatever the French did, Britain "could not at the

⁵ This information, which Morgenthau relayed to Bewley, was based on a telephone conversation with Cochran. A telegram from Cochran, reporting details of his discussions in Basel, was still being decoded. These details, when they became available, somewhat modified Morgenthau's initial statements. In the view of President Trip of the Netherlands central bank, a French devaluation of 25 to 30 per cent would be reasonable. Should the French devalue no more than this, he felt the sterling-dollar rate should not go below \$4.86. He also intimated that in these circumstances the guilder would be devalued 25 per cent against sterling. The president of the Swiss central bank, Bachman, did not commit himself in conversation with Cochran but apparently favored actions along the lines indicated by Trip.

present stage promise a permanent and absolute stability . . ." in its exchange rate.

Mönick's Mission

Morgenthau's efforts to facilitate a French devaluation in June failed not so much because of the diplomatic impasse between London and Paris as because Blum was preparing the ground for the move in his own style. It was the premier-designate, rather than Auriol, who provided the impetus for exploring the question of devaluation and who, even before he had formed a government, summoned Mönick in order to discuss the matter. Mönick's views favoring devaluation were well known. According to his own account of the meeting with Blum, Mönick based his argument on the urgent need to strengthen the French economy generally and, especially, its ability to rearm in the face of the Nazi threat. Responding to Blum's concern about the reactions of the United States and Britain, Mönick assured him that a moderate realignment of the franc would be regarded sympathetically by the other democracies. When Blum asked Mönick to obtain assurances on this point, Mönick proposed to visit Washington first. He was sure he could obtain support from Roosevelt; thereafter, "the British government would be unable to say 'no'." ⁶ A week later (June 6), when the government had been formed, Blum authorized Mönick to visit Washington and gave him a letter to Roosevelt expressing a general desire for closer cooperation. No specific proposals were made. Only after Mönick had departed did Auriol learn of the mission to Washington. ⁷

In the meantime Blum had to keep up appearances. Presenting his Cabinet to Parliament on June 6, he pledged that Paris would not awake one bright morning to the news that the franc had been devalued. ⁸ At the same time, he needed to cover himself against a reversal. Accordingly, ten days later he dropped a little-noticed hint to the Senate that a currency realignment might after all be possible within the framework of an international understanding. ⁹

The Blum government's preoccupation with the form in which the realignment would be announced was made crystal clear by Mönick in his

⁶ Mönick (1970, pp. 48-49). When Mönick approached British Treasury officials toward the end of July, he gave a different explanation for having broached the subject first with the United States. The French government, he said, wished, before reaching an understanding between two countries so close to each other from every point of view as the United Kingdom and France, to ascertain whether difficulties in the more distant country—such as a change in the gold content of the dollar or the presidential elections in November—might not preclude the taking of any monetary step by France.

⁷ *Ibid.*, p. 50.

⁸ Chambre des Députés, Séance du Samedi, 6 Juin 1936, p. 1334.

⁹ Colton (1966, p. 186).

Washington discussions. Visiting the President against the background of widespread civil commotion in France,¹⁰ Mönick painted a dark picture of European political developments and especially the defenselessness of Holland and Belgium against Germany's military buildup. In the face of this threat, devaluation was necessary in order to strengthen the French economy, but such a step could not be taken without international approval and support.¹¹ According to his memoirs, Mönick proposed that the three great democracies issue a joint declaration affirming their desire to restore international economic order, to promote a policy of world prosperity, and thus to assure the conditions for peace. In accordance with this declaration, the franc would be realigned and the three democracies would agree thereafter to maintain their exchange rates as stable as possible and to consult as often as necessary in order to coordinate their economic and monetary policies.¹²

At a meeting with Morgenthau on the following day, Mönick again emphasized the importance of form but also entered into a preliminary discussion of details. He alluded to the tenacity with which the French were clinging to the Poincaré franc. It was, he said, a battle without hope but there was honor in the fight. The government must make a "strenuous effort to keep on gold." It was a battle that "ought to be fought until the last moment." When devaluation came—as Mönick believed it inevitably would—it should be in a form that would not be humiliating to the French people. Rather, it should be presented as the conclusion of the exchange-rate war and the "beginning of monetary peace and some form of collaboration between the stable currencies." The Blum government could move only if the realignment were dressed up as a constructive act of international cooperation.

Turning to specifics, Mönick outlined a proposal that was to provide the basis on which the French authorities would gain a share in the day-to-day management of their exchange rate. He indicated that, in devaluing, his government might depart from orthodoxy by avoiding another fixed parity. Rather, it would seek, through purchases and sales of gold, to hold the rate within margins that represented a 25 to 28 per cent devaluation from the Poincaré parity. At the midpoint of this 4.5 per cent range, the rate would be 20.6 francs to the dollar and 100 to the pound. The relatively wide margins around the middle rates would be maintained only

¹⁰ Shirer (1969, Chap. 17) provides a vivid description of conditions in France during the spring of 1936.

¹¹ Memorandum by William Phillips on the meeting between Roosevelt and Mönick, June 23, 1936, *Foreign Relations of the United States, 1936*, Vol. 1, pp. 539-541.

¹² Mönick (1970, p. 52). It is notable that William Phillips's contemporaneous but brief account of the Roosevelt-Mönick meeting makes no mention of a joint declaration, exchange stabilization, and policy coordination.

during an interim period before the attainment of a "more definitive agreement" about an international standard. Such margins, Mönick emphasized, should apply not only to France but also to the British, who should be asked to keep the sterling-dollar rate within a similar \$4.75 to \$4.97 range. "There must be something very definite about that," Mönick said, "it would be a mistake for both of us to make this move and then to leave the pound completely free to fluctuate."

Without agreeing to any of these details, Morgenthau indicated approval of the general approach. He agreed that the margins would need to be wide at first but that they could then be gradually narrowed. France would need to establish an exchange fund with the devaluation profits. The funds of the three countries would cooperate in managing the exchanges. But before any details could be settled, the French would need to approach the British.

Anglo-French Discussions, July 1936

The French government did not immediately follow up Mönick's approach to Washington with another to London. Blum's stand against devaluation temporarily calmed the exchange markets. On July 15, 1936, Auriol told speculators that, in their own interest, they should sell their gold and foreign exchange because "the danger of devaluation is avoided. Mistrust might sometimes have been justified. It is no longer, because the policy of the government is sound."¹³ The Bank of France gained \$63 million in gold during July and its discount rate was cut in several steps to 3 per cent. With the pressure off the franc, Mönick returned to Paris, where he reported on his Washington discussions. He approached the British only toward the end of July 1936, when Blum visited London to discuss problems arising from Hitler's occupation of the Rhineland and the outbreak of civil war in Spain.

Preparing the way for a meeting between Blum and Chamberlain, Mönick summarized for British Treasury officials the substance of his Washington discussions, particularly France's exchange-rate proposals and the reaction to these by the Roosevelt administration. Having been assigned to London for more than a year, the French financial attaché was fully aware that the British authorities, while anxious to moderate exchange-rate fluctuations, were unwilling in the existing conditions to commit their country to any rigid structure of exchange rates. Nevertheless, he noted that both Britain and the United States had indicated that the gold value of their currencies would not be changed as the result of a moderate French devaluation and that they reserved the right to review their external monetary policies only in the event of major declines in

¹³ Sauvy (1967, p. 229).

domestic prices or large outflows of capital. The substance of these assurances was satisfactory, he said, but the French felt they should be given a somewhat different form. If Britain received the exchange-rate proposals favorably, the details of the commitment would not matter so much and the widespread impression that Britain was unwilling to cooperate with France would be dispelled.

The British, Mönick continued, had already indicated their willingness to cooperate by indicating, like the Americans, that they would maintain so far as possible certain parities between the pound, the dollar, and the franc. What the French government wanted was that this should be explicitly stated and accompanied by the corollary commitment that fluctuations around those parities should be kept within $2\frac{1}{4}$ per cent margins. Such commitments, he held, would provide France with the effective collaboration that, after her honorable effort to defend the franc, she felt was deserved and without which no orderly currency realignment could be accomplished. The alternative would be a turn toward autarky. The French economy would continue out of joint, with all the inherent dangers not only for domestic tranquility but also for the peace of Europe.

Predictably, the British authorities refused to give the assurances asked by the French. They had no legal power to link the pound with gold, nor was it their policy to do so. Rather, their policy was so to manage sterling as to suit their own economy. In practice, they would probably wish to keep the pound fairly stable in terms of gold, but it was easy to imagine contingencies that would require either depreciation or appreciation. However, since the British government did not wish to give offense by outright rejection of cooperation, some formula that meant very little would have to be found. Moreover, such assurances as were given should be to the French alone; it would be preferable if reference to Washington could be avoided.

This view was reflected in a letter to Blum that was drafted at the end of July for Chamberlain's signature. After expressing a desire to cooperate, the letter indicated that the British would acquiesce in the proposed realignment provided the French currency were depreciated to no more than 100 francs to the pound. Reprisals, such as a further depreciation of sterling or the adoption of discriminatory tariffs against French imports, would be entirely contrary to British policy and would not follow the contemplated change in the franc. However, in order to avoid misunderstandings, the letter stated that no guarantee could be given that sterling would "be linked to gold between fixed points" and that the recent steadiness of sterling "might seriously be affected by any further devaluation of the franc beyond what is now in contemplation or of the dollar."

This letter was a negotiated document; Mönick and other French officials participated in its preparation. Although its contents were thus known to the French, the plan at this stage was that it should remain unsigned by the Chancellor and be sent to Blum only after the French had indicated that devaluation was imminent. The ostensible reason for this procedure was that the British did not wish to appear to be pushing Blum into devaluation. Another reason seems to have been that British officials wished to avoid discussions with Morgenthau, whose ambition, they believed, was to take to himself the credit for a tripartite agreement. The suggestion at this stage was that the letter should be sent to Morgenthau only when it was signed and delivered to Blum.

Anglo-American Discussions on Convertibility

This renewed aloofness, following the brief interlude of cordiality between the British and American Treasuries around the beginning of June 1936, probably arose largely out of Morgenthau's response to an inquiry from London testing American intentions regarding external monetary policy. As the likelihood that France would abandon the gold standard increased, the British had become concerned that their freedom to manage sterling might be narrowed. If France not only devalued but also abandoned the free convertibility of francs into gold at a fixed price, the principal basis on which the EEA influenced the sterling exchange rate would disappear.¹⁴ To be sure, the British would still be able to influence the exchange rate through operations in the London gold market, but such operations were regarded as a weaker instrument than purchases and sales of a gold currency. Accordingly, a few days after Chamberlain's letter of cooperation had breached the wall between the two Treasuries, Bewley formally asked Morgenthau whether Britain could convert dollars into gold. The Secretary explained that he could not respond immediately but that the existing restrictions on U.S. gold sales were purely a policy matter and could be changed if the administration decided that liberalization "was in the mutual interest of both countries." The following day, when Morgenthau was attempting to obtain British approval of his proposed joint statement to France, he hinted to Bewley that a favorable response from the Chancellor would be followed by the desired liberalization of U.S. gold policy.

After this, the subject was apparently dropped until July 22, when Bewley was about to return to England on home leave. Having completed discussions with Mönick in the meantime, the Secretary was seeking an explicit commitment from Britain that would minimize the fluctuations of

¹⁴ Clay (1957, p. 424).

sterling. When Bewley noted that he had still to learn whether Britain could convert dollars into gold, Morgenthau responded in the affirmative, adding the proviso that the British should reciprocate. He then proceeded to elaborate with figures which he called purely hypothetical but which were consistent with his interpretation of Chamberlain's message of June 1, 1936. The United States might sell gold when the sterling-dollar rate was \$5.00 if, in turn, the British would sell gold when the rate was \$4.90. Morgenthau was suggesting, in effect, that the British should stabilize sterling in terms of gold at about 141 shillings per ounce, with a sterling-dollar middle rate of \$4.95. His hypothetical range for fluctuation was slightly more than 2 per cent, compared with the 4.5 per cent suggested by Mönick as appropriate for the interim period.

In his diary, Morgenthau noted that Bewley was startled by the proposal. Understandably! Even allowing for bargaining tactics, the Secretary's proposal was a long way from what the British viewed as reasonable. They were still unprepared to stabilize sterling on gold, let alone within a range above the lamented \$4.86 that had had to be abandoned in 1931. Even if they had been willing so to stabilize, the suggested range would doubtless have been regarded as far too narrow. The response that Bewley obtained from the Secretary thus served only to confirm the previously held views of British officials that "no one can collaborate with Mr. Morgenthau."

IV. THE FINAL NEGOTIATIONS: SEPTEMBER-OCTOBER 1936

After a further lull in August, when most Europeans were vacationing, the pressure against the franc resumed. Legislation adopted by the Blum government to shorten the work week and provide for paid holidays added to the already relatively high costs of French industry. With expectations widespread that devaluation could no longer be postponed, the Bank of France showed a further substantial gold loss in September.

Against this background, the three democracies resumed discussions of the various issues that had been raised earlier in the summer and, in some cases, resolved them in unexpected ways. The Blum government was as anxious as ever that the devaluation not only satisfy France's competitive needs but also be presented to the public as a great act of international cooperation and statesmanship. On these issues, the negotiations were difficult but fairly straightforward. However, in all three countries these aspects of the negotiations were increasingly overshadowed by other considerations. Realizing that the size of the French devaluation was less significant to the United States than the level at which the sterling-dollar rate settled, Morgenthau used such bargaining power as he had in an attempt to obtain from Chamberlain an exchange-rate understanding satisfactory to the Roosevelt administration. Although the British authorities were able to evade an exchange-rate commitment to Morgenthau, they were less successful in defending the freedom of their exchange-rate policy against the French, who reshaped their monetary arrangements in such a way that control over the key franc-sterling rate would be shared between London and Paris.

Auriol's "Pre-stabilization Plan"

In the discussions that began on September 4, Auriol seems to have hoped that, with American support, he could persuade Britain to move decisively toward exchange stabilization. The substance of his initial proposal was very little changed from that outlined earlier by Mönick in Washington and London. Chamberlain's draft letter to Blum was twisted to satisfy French aims. Auriol knew, of course, that the U.S. administration favored the stabilization of sterling at about the existing \$5.00 level. In the interest of lining up support, therefore, his initial approach was to the Americans. Noting that the United States had been the first to offer him cooperation, the Finance Minister asked Morgenthau whether he preferred that the draft of the French "pre-stabilization" plan be submitted secretly to him in advance of the British or that copies be submitted

simultaneously to the two countries. Morgenthau, refusing to take the bait, immediately responded that he preferred the latter. He also practiced a little one-upmanship by informing London of the French approach and of his request that the draft be sent to the two governments simultaneously.

Auriol's draft, which reached Washington on September 9, comprised two parts: (1) a note setting forth the views of the French government on international economic policy and (2) an agreement on exchange rates among the three governments. The note was the sugar coating intended to make devaluation palatable to the French public. France, the draft stated, had always rejected "unilateral devaluation," which was susceptible to retaliation. Rather, it sought "real economic and monetary peace." Hence, France was ready to seek new monetary relations that would remedy the international disequilibrium occasioned by the fall in world prices and the devaluation of certain other currencies. An agreement that defined these new relations with "precision and clarity" would make possible immediate and vigorous action to reduce obstacles to trade.

The proposed agreement among the three governments was to specify the range of exchange rates among the franc, the dollar, and sterling. The three governments were to promise to devote all their efforts to maintaining the agreed exchange relations and to collaborate in order to do so; the exchange-rate margins would "not be modified except by common accord," unless exceptional and unforeseen circumstances arose. The final objective would be a general return to the gold standard when the necessary conditions had been realized. However, neither the exchange rates nor the margins that the French authorities contemplated were specified in this draft.¹

The initial response of Morgenthau and his colleagues was generally favorable to the French proposal, although some reservations were voiced. The Secretary could not promise to return eventually to the gold standard because that "is not the Roosevelt philosophy." Nor could he sign anything that would commit the United States to keeping the dollar within fixed margins. However, while rejecting any formal arrangement, Morgenthau did favor an informal tripartite agreement on stabilization, to come into operation after the French devalued. Under such an agreement, Britain, France, and the United States might each put up the equivalent of \$100 million to manage the exchanges. The three countries "should arrive at figures for the upper and lower points of exchange in relation to each other and fix points at which each stabilization fund would furnish gold for shipment when necessary to keep the exchanges from

¹ Telegram No. 844, Ccchran to Secretary of State, Sept. 9, 1936, *Foreign Relations of the United States, 1936*, Vol. 1, pp. 543-545.

going past the points agreed upon. . . ." The exchange margins should be very wide at first but "as we gain some experience and find that it is working out successfully then these points can be gradually narrowed down." If such an agreement were negotiated, the United States would be willing to convert dollars into gold, presumably on the reciprocal basis outlined to Bewley toward the end of July. The Secretary emphasized that "we will not sign a thing"; it would be "a gentleman's agreement. . . . We would do everything to make it successful, but we would have to watch our internal price level just as they would."

Since Auriol's note was described as a proposed draft, the immediate response that Morgenthau sent to France touched upon only a few of these considerations. He indicated that the U.S. government was sympathetic to France's problems, that a realignment of the franc would bring added stability to the exchange markets, and that such stability would lead both to an expansion of international trade and to the elimination of the "disturbing and unwelcome movement of funds" between international financial centers. He emphasized the desire of the American authorities to maintain the stability of the dollar in the exchange markets and their willingness, in the event of a realignment of the franc, to "continue to use appropriate available resources" (i.e., the Exchange Stabilization Fund) for such stabilization purposes in "the confident expectation" that the British would do the same. He noted, however, that any such cooperation in the exchange markets would be subject to review in the light of domestic economic developments. He also suggested that France's immediate needs could be met without an American commitment to return eventually to the gold standard.²

In sharp contrast to Morgenthau's generally sympathetic reaction, British Treasury officials found Auriol's preliminary note "even more hopeless" than they had expected. On presenting the French note, Mönick had said that it followed as closely as possible the views expressed by Chamberlain in his July draft letter to Blum. If so, the contents of the note only indicated that Auriol "has never understood the views in question," because, in the face of Chamberlain's clear opposition, the French had proposed a stabilization agreement.

Reviewing the accepted doctrine in a memorandum for the Chancellor, Sir Frederick Phillips noted that, in making such an agreement, "we should be sacrificing our liberty of action as regards the control of credit." True, the exchange values of 1 pound sterling equivalent to 100 francs and to \$4.75 to \$4.97 mentioned by the French in July would "suit us very well" in the existing circumstances. However, if France and the United

² Telegram No. 342, Morgenthau to Cochran, Sept. 9, 1936, *Foreign Relations of the United States, 1936*, Vol. 1, pp. 545-546.

States were to restrict credit, sterling would fall to \$4.75 and Britain would lose gold and be forced to follow suit with a more stringent monetary policy. On the other hand, a lax credit policy abroad would bring Britain a flood of gold which could be checked only by a relaxation of monetary policy that might be considered unwise. International collaboration on credit policy was still a long way off, particularly as the central banks of both France and the the United States had been changed in status from independent institutions to government offices.

Another objection to stabilization was, in Phillips's view, that the fixing of margins for exchange fluctuations would strengthen the position of the speculator and would consequently increase, rather than diminish, the difficulty of keeping sterling on an even keel. Turning to negotiating problems, British officials were annoyed because, in communicating their proposal to the United States, the French had taken "the question entirely out of the sphere in which the Chancellor has hitherto considered it." Discussions with Morgenthau were viewed with distaste in the best of circumstances but were expected to become thoroughly disagreeable with the approach of the presidential election.

The British were also unhappy about the alternatives that they expected the French to take if Auriol's stabilization scheme was rejected. One possibility was that they might follow the Germans by resorting to exchange controls, which would have extremely bad effects on international trade. A more likely outcome, Phillips wrote, was that they would attempt to control the exchange value of the franc on the basis of operations in gold, dollars, and sterling, but mainly sterling.

Should that happen, the practical control of the exchange between London and Paris will have passed from our hands to those of the French, and we shall be unable to retaliate in any effective manner however low they allow the franc to fall in terms of sterling. Moreover it would be much more difficult for us to control the value of sterling in terms of gold when it is no longer possible for us to purchase francs in Paris with a certainty of being able to convert them as we please into gold bullion. Our efforts to control the external value of sterling would be practically limited to operations in the London gold market, in the absence of any arrangements with the Americans similar to those we have had with the French.

However, this alternative would also have a drawback for the French, who would find it troublesome to be handling large amounts of sterling with no assurance as to its gold value.

Since no alternative was trouble-free, the British government decided to stand pat on the position taken in Chamberlain's July draft letter to Blum. A note handed to Mönick on September 14 held that Auriol was now advancing an entirely different proposal from the one contemplated

in July. The Chancellor could not "limit his power of independent action by a formal agreement" such as the French were now proposing. At the same time, the note reiterated in more high-sounding language the assurances given in the July draft letter and emphasized that the

maintenance by each country of the greatest possible stability in monetary relations and a due consideration at all times for the effect of its decisions upon other countries afford, in the Chancellor's opinion, a more desirable as well as a more practical basis of cooperation at this stage than any formal convention.

Simultaneously, Fisher informed Morgenthau of the substance of the note given to the French, as the Chancellor was vacationing in Scotland. In his message, Fisher particularly emphasized "that it would not be possible for the Chancellor to guarantee that the pound sterling should be linked to gold between fixed points."

In view of the Secretary's earlier attempt to obtain a British commitment to hold sterling between narrow margins, it is curious that Morgenthau told Mallet, the British Chargé in Washington, that the spirit of Fisher's communication was "very acceptable."³ From this reaction, the London authorities had reason to conclude that they did not need to take seriously the stabilization proposals Morgenthau had mentioned to Bewley in July and that he was to press on the Chancellor as the tripartite negotiations approached their climax. Forwarding the substance of Fisher's message to Cochran in Paris, Morgenthau noted that it was essentially the same as the American response to Auriol. In Morgenthau's view, there seemed to be "an adequate basis for continuing the discussion between the three Treasuries."⁴

The Declaration

With these responses from the Americans and British, the French proceeded to draft a declaration that they hoped the three governments could issue as cover for the franc's devaluation. In Paris, officials were still deeply concerned about the reaction of the French public. On reading Morgenthau's September 14 message, Baumgartner told Cochran that he would have a problem convincing Auriol that the British and American replies would adequately mask the devaluation. Cochran reported to Morgenthau that the Minister of Finance, confronted by tense labor difficulties, did "not want to give the public and particularly the Communists a reason through undisguised devaluation for rioting and possibly upsetting the French Government."

³ Telegram No. 348, Morgenthau to Cochran, Sept. 14, 1936, *Foreign Relations of the United States, 1936*, Vol. 1, p. 547.

⁴ *Ibid.*, pp. 546-548.

Because of these domestic concerns, the draft that Auriol proposed for signature by the three governments retained most of the admirable but empty sentiments that had been included in September 9 "unofficial" draft. However, surrendering to the adamant opposition of the British, Auriol did drop the key proposal that the three governments should agree to specify fixed margins within which their exchange rates would fluctuate. With the omission of this provision, the draft remained little more than a declaration in favor of the international economic equivalent of motherhood. The three governments were to declare their support for world peace, liberty and prosperity, and an improved living standard for all social classes, as well as their opposition to "unilateral monetary manipulations" and restraints that paralyzed trade. Backing into the subject of devaluation with the obscurantism for which the monetary authorities had become justly famous, the draft indicated that France had decided to adjust its currency on the basis of world prices and in the interests of international monetary stability. The Treasuries and banks of issue of the three countries would cooperate to implement this decision and to assure maximum international monetary stability, the final objective being a complete return to the international gold standard. The three governments would endeavor to regulate, if necessary by negotiations, any international monetary strains that might arise from exceptional domestic economic difficulties.

In presenting this draft, Auriol made what Cochran reported as "a really beseeching plea" that the U.S. government accept the proposed declaration. The Minister believed that a joint declaration would provide better evidence of cooperation than three simultaneous, somewhat different declarations. He said, according to Cochran, that

a joint declaration over the names of President Roosevelt, Secretary Morgenthau, Premier Baldwin, Chancellor Chamberlain, and Premier Blum would give the world the first real evidence since the war that the three great powers are genuinely cooperating. He thinks a monetary peace on this foundation will be the basis for working toward economic peace and finally achieving political world peace.⁵

When it reached Washington, Auriol's proposed declaration found virtually no support. It left Morgenthau disappointed and discouraged. He and his associates saw innumerable obstacles. The administration could not "talk about social classes in America." Reference to an eventual return to the gold standard was as objectionable as ever. An adjustment of the franc in accordance with changes in world prices could sanction a 30 to 40 per cent depreciation—far more than the 15 to 25 per cent preferred by

⁵ Telegram No. 884, Cochran to Morgenthau, Sept. 17, 1936, *Foreign Relations of the United States, 1936*, Vol. 1, pp. 548-550.

the administration. William Bullitt, U.S. Ambassador to France, who discussed the draft with Morgenthau and his associates, suggested only half facetiously that the Paris authorities wanted "to sell [the adjustment] to the French people" as an appreciation of the dollar and sterling rather than a depreciation of the franc. They were aiming "to make it look as if America and England had finally realized that their currencies were wrongly valued." It was especially annoying that there was still no indication of how much the French intended to devalue. Without this information, Morgenthau could sign no declaration. Auriol's draft was "just shadow boxing . . . a lot of hooey."

When Roosevelt read the draft, his reaction, according to Morgenthau, was: "It's terrible! It gives me a pain!" As he reviewed each section, Morgenthau reported that the President said:

Section two—no like. He particularly disliked "maximum stability." The last of Section two—gold standard—OUT! with a very loud voice; sounded like Ouch! Under Section three, paragraph three, where it says "world prices"—Why don't they say something about maintenance of price levels within each country? The Section four, paragraph one, where it speaks of "banks of issue." He crossed that out. Again they speak of maximum stability. "Out!" "In order to reach the final object [*sic*] which consists of the complete return to the international gold standard"—out! out!

In the light of this reaction, Morgenthau turned against the French proposal for a joint declaration and instead favored the simultaneous issuing of individual statements by each of the three governments. By eliminating reference to the issues on which there was disagreement and concentrating only on those on which their views harmonized, it would be possible to draft nearly identical statements and so give the desired impression of cooperation. However, the statements would be issued "only when the specific limits of a mutually acceptable alignment of the *three* currencies have been determined."⁶

Building on this basis, Morgenthau and his associates prepared a new draft designed to satisfy the diverse requirements of the three governments. Suitable parts of the British note of September 14 to the French and of the Auriol draft of September 17 were combined with native American bureaucratese into a draft that was submitted to London and Paris for comments on September 19. Thereafter, many drafts and comments crossed and recrossed the trans-Atlantic cables until, on September 25, 1936, the three governments simultaneously issued virtually identical statements that were high sounding, involved no binding com-

⁶ Telegram No. 359 from Morgenthau to Cochran, Sept. 19, 1936, *Foreign Relations of the United States, 1936*, Vol. 1, p. 553. Italics added.

mitments, and successfully obscured the fundamental differences among the three countries.

Pronouncements favoring peace, prosperity, improved living standards, and the maintenance of international economic balance occupied much of the statements. The necessity of taking "into full account the requirements of internal prosperity" was emphasized. Britain and the United States "welcomed" the French currency adjustment in the hope that it would "establish more solid foundations for the stability of international economic relations." The three governments declared their intention "to continue to use the appropriate available resources so as to avoid as far as possible any disturbance of the basis of international exchanges resulting from the proposed readjustment." Consultations among the three governments for this purpose would be arranged. Great importance was attached to prompt relaxation of existing quotas and exchange controls. Finally, other countries were invited to support the declared policies of the three governments and the hope was expressed that no country would attempt "to obtain an unreasonable competitive exchange advantage and thereby hamper the effort to restore more stable economic relations."⁷

Exchange Rates and the Twenty-four-Hour Gold Standard

The technical negotiations on exchange rates on which the publication of the declarations depended were complicated. They involved not only the extent of the devaluation that would be tolerable but also the way in which the exchange markets were to be managed after the franc adjustment. The first issue was initially Morgenthau's principal concern, as he sought to defend the international competitive position of the United States. Although the British authorities had similar preoccupations, they were at least as much concerned to retain continuing control of sterling's exchange rates. In the field of exchange-rate management, however, the French refused to continue in the passive role they had theretofore played under the gold standard. In particular, they sought a voice equal to Britain's in the management of the sterling-franc rate. The resolution of this Anglo-French clash produced the novel arrangements that came to be known as the twenty-four-hour gold standard.

Anglo-French negotiations, September 14-27. Although the British and French negotiators haggled vigorously, they were never really very far apart regarding the extent to which the franc should be devalued. Employing the expected bargaining tactics, the British started the discussions by suggesting a relatively small adjustment while the French fa-

⁷ The statements of the three governments are published in *Bank for International Settlements (1937)*.

vored a relatively large one. Speaking for the Bank of England, C. F. Cobbold blandly took it for granted that the franc, which was being held at about 76 to the pound sterling, would be depreciated to the 100 mentioned in Chamberlain's July draft letter to Blum. Responding for the Bank of France, Governor Labeyrie contended that, while the 100-franc rate might have been appropriate earlier in the summer, it was now too low. In view of the relative increase in French costs and prices in the meantime, he thought a rate within the 110-120-franc range would be appropriate.

In fact, in discussions among themselves, British Treasury officials recognized that France's competitive position was significantly weaker than it had been two months before and that a rate at the lower end of the range suggested by Labeyrie might be appropriate. In a note prepared for the Chancellor, Hopkins conceded that the acceptance of a 110-franc rate would doubtless increase the grumbling from British manufacturers and farmers. Nevertheless, he continued:

It is highly important that the French operation should succeed, and French trade needs a very considerable stimulus if it is to be lifted out of stagnation and conditions created under which French capital that has taken refuge abroad is attracted back to the French. On the whole Sir F. Phillips and I would not be inclined to regard the choice of 110 francs as a reason for refusing co-operation.

Perhaps because they were anxious not to jeopardize the issuance of the desired declarations, the French kept their devaluation well within the limits of what was tolerable to London and Washington. Fournier informed Cobbold on September 22 that the gold value of the French currency would probably be established between margins that represented a 25 to 33½ per cent devaluation from the Poincaré franc; the exchange rate would be held about halfway between those margins.

Fournier's statement notwithstanding, the exchange-rate intentions of the Paris authorities remained ambiguous, partly because at this stage the French themselves had apparently not yet decided whether they would peg to sterling or the dollar. The British, of course, preferred the latter, since the EEA would then retain some latitude to manage the sterling rates against both the franc and the dollar. The possibility that the franc would be pegged to sterling introduced another source of ambiguity, because the mid-point to which Fournier referred would in that case depend on the sterling-dollar rate. With this rate then at about \$5.00, Cobbold calculated that the implied margins of the sterling-franc rate would be 100 to 113 and the mid-point 106.5; if sterling fell to \$4.86, the margins would be 98 to 110 and the mid-point 104.

Faced with these ambiguities, British and French negotiators were un-

able to resolve their differences about the rate at which sterling should open in Paris after the devaluation. On Sunday, September 27, two days after the declarations had been published, discussions were still continuing. Both sides agreed that a strengthening of the franc after the opening would be desirable but disagreed on the level from which the rise should start. Cobbold and Bolton argued at length for opening at 103 or alternatively 104, with a view to bringing the rate back to 103. For his part, Fournier insisted on opening at 106 and moving to about 105. An impasse was reached, with Fournier refusing to go below 106 and Cobbold refusing to go above 104. As it turned out, they split the difference, and the opening rate for sterling in Paris was about 105 on October 2.

While negotiations on the size of the franc devaluation involved only the expected haggling, those concerned with the future management of the sterling-franc exchange rate became intense. During the summer, the chances had seemed fair that French traditionalists would prevail on the Blum government to devalue "on gold" and thus satisfy Britain's need for a basis on which to manage sterling. In order to reinforce such traditional views, Catterns had urged that a commitment from the French to maintain a gold standard after devaluation be required as a condition for cooperation. But British Treasury officials felt that, since Britain was determined to stay off gold, they were in a weak position to insist on such a commitment from the French. Consequently, the upshot of the July discussions was ambiguous. Although Mönick apparently gave some ground for hope that the traditionalist view would prevail, he seems nevertheless to have left his government ample room for maneuver. He did say that his government intended to establish widely spread upper and lower gold points but refrained from indicating how the franc would be managed within those margins and particularly whether it would follow sterling or the dollar.

This ambiguity heated up the discussions when they resumed in September. Meeting with Labeyrie and Fournier on September 22, Cobbold stated that the Chancellor's July letter "had been based on the presumption that the intention of the French Government was merely to alter the gold parity of the franc, returning immediately to a full gold standard and making no other changes." Although the Chancellor had not yet received any official word that the French would follow a different course, Mönick had communicated vague details of what appeared to be an "entirely fresh" proposal which, Cobbold suggested, might cause the Chancellor to have second thoughts about going forward with the declaration so much desired by the French.

When the French plans to devalue to about the middle of greatly widened gold points were officially communicated, the British reacted

sternly. Leith-Ross told Mönick on September 23 that the proposals were "very different" from the ones that had been outlined earlier and that

the Chancellor had received a painful impression of lack of candour on the part of the French Government. The Finance Minister had expressed the desire for frank and loyal collaboration, but the procedure adopted did not appear to conform to this principle.

In any event, Leith-Ross was skeptical about the workability of the new proposal. One of two things might happen, he thought. If confidence in the franc revived, capital would be repatriated and the Bank of France would accumulate large quantities of sterling, which the British could not commit themselves to convert into gold. Alternatively, if confidence did not revive, the franc would fall to the lower gold point. In this case, the French would be anxious for the British to support the franc, which could be done only if such francs were convertible into gold. In an effort to keep the French tied up while maintaining British freedom, Leith-Ross told Mönick:

It would be far better for the French to go back to a gold standard after devaluation and leave sterling to adjust itself. There might be variations in the sterling-franc rate, but we would do our best to limit fluctuations insofar as this would be consistent with the relative level of prices, etc., in the two countries.

If the French followed such a course, the Chancellor would be prepared to "join in a declaration couched in as cordial terms as possible" and would "do his best to help in meeting any difficulties" that might arise. On the other hand, if the proposal were adopted in its present form, the Chancellor would

issue some statement that while we wished the French Government every success and would not seek to put any impediment in their way, we had no responsibility for their proposals and we could only work in with it so far as was consistent with our national interests.

In the face of this pressure, Mönick held his ground. If there had been some confusion about the arrangements to be adopted, it was because the Blum government had only recently arrived at its final decisions. The French would make no "attempt to tie Great Britain to gold or to keep sterling at a given level." It was true that the immediate aim was to keep the franc about midway between the two gold points, but if either the British or the French wished to depart from the implied sterling-franc rate, "each side reserved its full liberty." Questioned by Leith-Ross whether, in the event of heavy capital repatriation after the devaluation, the French would attempt to keep the exchange rate at this mid-point, Mönick replied that there was no question of a fixed rate; the French gov-

ernment desired the franc "to follow" sterling but gave Britain "full liberty as they themselves had full liberty."

Mönick's response touched the central weakness of the British position, of which the monetary authorities in London were fully conscious. Writing to the Chancellor a few days before Mönick's encounter with Leith-Ross, Hopkins had noted the difficulties of attempting to persuade France to maintain the gold standard at the same time that Britain insisted on retaining its freedom to manage sterling. Were Britain to insist that the price of cooperation was the maintenance of a full gold standard under which *all countries* could exchange francs for gold on demand, the French could be expected to "react strongly." They could reply, Hopkins wrote, that "it was unreasonable of us to require other countries to model their currency arrangements simply by reference to our convenience in managing an unstable currency." On the other hand, if the French were to propose an American type of arrangement under which convertibility would be extended only to other gold-standard countries, Britain would be ineligible to convert francs into gold and would consequently have no basis on which to manage sterling.

However, another alternative, which was favored by Hopkins and Phillips and which Leith-Ross believed would be accepted in Paris, was to insist that the French enter "into a specific agreement with us that they will at all times give gold to the Bank of England against francs on demand." In persuading the French to accept such convertibility arrangements, Hopkins wrote:

Our real weapon against the French . . . lies in their extreme need of our assistance at this juncture. If we say to them that upon the basis of an arrangement under which they will give gold without question at all times to the United States and never to us, no co-operation will be forthcoming from here and they must expect to see sterling far less stable in future than it is to-day, they will undoubtedly take notice. At the worst, of course, the attack could also be opened upon a wider field inasmuch as there are many spheres in which the French need our assistance in international political relations.

Any French proviso that such a convertibility agreement should cease to operate if sterling fell below a certain level, say, 90 to 100 francs, would have to be resisted; it might be regarded as a step toward stabilization and could consequently be most embarrassing. Another French suggestion might be that the arrangements should be reciprocal and that

we should give them gold against sterling on demand at any time. Our answer could only be that, as we are not on the standard, we cannot undertake to give gold to anybody but that there is always gold to be bought in substantial quantities on the open gold market in London. This answer may satisfy the French when hungering for assistance though not otherwise.

In an addendum to the same memorandum, Hopkins came still closer to the twenty-four-hour gold standard. Noting that the French proposed a "working arrangement" between central banks "to peg the franc to the pound at a fixed point," he wrote:

This is precisely what we could not stand. . . . While we cannot have any "working arrangement" to stabilise the pound on gold, we can no doubt give the French, when we have got our essential requirements from them for keeping our hands untied, some assurances that the kind of consultations and arrangements which now proceed between the Banks will continue.

Across the Channel, Bank of France officials were also seeking to resolve the impasse. Traditionalist ideas were shelved. In discussions with Cobbold on September 17, Fournier stated that the French government was determined to have a voice in the management of the sterling-franc rate. Hence, they would not go back to a full gold standard with the obligation to deliver gold against francs to all countries. Rather, they would follow the American model, establishing an exchange-equalization fund and supplying gold automatically only to gold-standard countries. With respect to other countries, and especially Britain, Fournier hoped that the French and British exchange funds could cooperate by agreeing both on reciprocal deliveries of gold and on exchange rates. To Cobbold's objection that his government would reject any commitment to maintain specified exchange rates, Fournier replied that he understood the Chancellor's objection to any *long-term* commitment but hoped an agreement could be reached to maintain specified exchange rates for only *short* periods. According to Cobbold's report, Fournier stressed the desirability of arrangements on "reciprocal delivery of gold as he would neither wish to take a risk in sterling nor expect us to take a risk in francs." After further discussion, Cobbold indicated that he believed it might be possible to make arrangements under which "both parties would agree to deliver gold against currency purchased by one party at rates agreed with the other."

This proposal was given precision in a document handed to Leith-Ross by Mönick at 11 P.M. on September 23, only a few hours after their earlier discussion had ended in apparent deadlock. The document, authorized by Auriol, provided for cooperation between the British and French exchange funds on the following basis:

The two Exchange Funds will concert, from day to day, in order to ensure so far as possible the maintenance of the mean parity of exchange adopted (for example, 105). The two Funds will be able daily to convert into gold at the price of the day the currency of the other country which they hold.

The sterling-franc rate would be subject to alteration in order to conform

with changing economic conditions, any difficulties in executing the arrangement being remedied in a "spirit of friendly cooperation." An addendum to the note suggested by Leith-Ross was that "if the pound were to depreciate in terms of gold beyond the point corresponding to the lower limit of devaluation fixed for the franc, an adjustment of the franc-sterling rate would inevitably have to take place." To this Mönick commented that Paris had no objections in principle but felt "it would be distasteful to be so precise." The arrangements were to remain secret.

As to operating details, it was subsequently agreed that the two exchange funds would inform each other each morning if they proposed to deal in sterling or francs. If the other party agreed to such dealing and to the rates at which it was proposed to deal, a gold price would be specified at which each central bank would be prepared at the close of business to sell gold to the other in exchange for its currency. The specified price was subject to change during the day in accordance with movements in the dollar exchange rate. The right to obtain gold at the relevant price would expire at the end of each day for any unconverted balances.

Striving to the end to maximize British freedom, Bank of England officials proposed that Britain should control the sterling-franc rate, while the French controlled the dollar-franc rate. The suggestion was rejected by the French, who insisted that the Bank of France would deal in both currencies and that each central bank should deal in its own market for its own account. To this the British agreed provisionally but noted that they could neither allow the French a larger voice in managing the sterling-franc rate than they had themselves nor allow "rates to be rigidly maintained by the French and Americans which would automatically peg the sterling-dollar rate." Summing up the spirit of the arrangements, Fournier wrote that they reflected: "ni accord, ni entente, uniquement coopération journalière."⁸

The U.S. retreat on exchange rates. In contrast to the British and French, the Americans were not primarily concerned during the final hectic week of negotiations about arrangements to manage the exchange markets. Apart from formulating an acceptable declaration, Morgenthau and his colleagues focused during this period chiefly on the exchange rates that would be established after the French devaluation. In the process, they shifted targets as Morgenthau came to realize that the dollar rate against sterling was of greater importance to the United States than that against the French franc. As regards both exchange rates, their achievements fell considerably short of their goals.

From the beginning of the negotiations in early September, Morgenthau had taken for granted that the publication of the declaration desired

⁸ Sayers (1976, p. 480).

by the French was contingent on agreement about exchange rates. When Mönick had visited Washington in late June, Morgenthau was prepared to accept a franc devaluation as large as 25 per cent. However, when Cochran reported on September 18 that the French were proposing to devalue within a 24 to 32 per cent range, Morgenthau raised no objections. His failure to react may have arisen partly from knowledge of the extent to which France's competitive position had deteriorated during the summer. More likely, however, it stemmed from Morgenthau's concern that the sterling-franc rate being negotiated across the Atlantic might imply a sterling-dollar rate unacceptable to Washington.

For many months the administration had been angling to obtain a commitment from the British to hold sterling in the neighborhood of \$5.00. As the November presidential election approached, the value of such a commitment appeared to increase. Chamberlain's letter of June 1, 1936, had been comforting but somewhat vague; no specific assurance had been obtained that the exchange rates being negotiated in London and Paris would satisfy the administration's needs. On September 18, Cochran had indicated only that the sterling-franc rate was expected to be in the 100 to 110 range. Calculations prepared for Morgenthau indicated that a French devaluation of 32 per cent combined with a sterling-franc rate of 110 would imply a sterling-dollar rate of \$4.98, near enough to the administration's target. But the same devaluation combined with a sterling-franc rate of 100 would imply a sterling-dollar rate of \$4.53, which, Morgenthau said, "we cannot stand."

During the following week, Morgenthau and his associates devoted much effort to the attainment of the administration's objectives on the range of exchange rates. Their negotiating position was awkward. To be sure, the desired declaration could be used as leverage on the French. However, with respect to the British, Morgenthau's sole bargaining counter was to grant the privilege of converting dollars into gold, but on this subject he had heard nothing directly from London since his July 22 conversation with Bewley. Nevertheless, the British still had the subject on their minds. Morgenthau learned on September 22 that Cobbold had asked the French whether any agreement had been reached with the Americans on gold-conversion arrangements. On the following day, Fournier formally inquired whether the United States would enter into arrangements under which balances acquired by the stabilization funds of the two countries would be convertible into gold on a reciprocal basis at rates that were subject to change from day to day.⁹

These inquiries raised Morgenthau's hopes that he might be able to

⁹ Telegram No. 908, Cochran to Morgenthau, Sept. 23, 1936, *Foreign Relations of the United States, 1936*, Vol. 1, p. 555.

bring the gold-conversion bait into play. Against this possibility, the Secretary sent to Cochran on September 23 a proposed announcement that the Treasury would sell gold at \$35 per ounce, plus handling charges, to the stabilization funds of countries that would likewise sell gold to the United States on terms and conditions deemed satisfactory by the Secretary. The Treasury would reserve the right to change or terminate the arrangement on twenty-four hours' notice. Advising Cochran to await further instructions before using the proposed announcement in any negotiations, the Secretary cabled that the French and the British should understand beyond question that, until the range of exchange rates was settled, possible arrangements for the release of gold between the three centers could not be determined.¹⁰ He particularly complained that he had as yet heard nothing definite about the sterling-dollar rate contemplated. Clearly, the unwritten message was that conversion privileges would become available to the French only when the British gave the required exchange-rate commitment to the United States. Thereupon, the Secretary sat back hoping that the desperate French could persuade the British to bite.

He waited in vain. Most of Thursday, September 24, passed. French gold losses were mounting and the pressure from Paris for agreement on the declaration became insistent. In the meantime, Morgenthau received corrected information to the effect that the margins for the French devaluation were 25 to 34.35 per cent, slightly more than he had been told earlier.¹¹ He also had intimations—false as it turned out—that the British and French had agreed on an opening rate of 105 francs, with the sterling-dollar rate at \$4.86. On being informed, Roosevelt reacted strongly: such a low rate was “just out of the question.” With sterling being quoted at \$5.07, he saw “no use” in going below a middle rate of \$5.00.

With the President's view crystallizing, Morgenthau was determined to smoke out the British. He had an opportunity late on the twenty-fourth, when Mallet and Chalkley came to his office to discuss last-minute changes in the declarations. When these refinements had been completed, Morgenthau observed that he felt negotiations were being conducted in reverse order. The declarations, he said, should have been prepared last. Of first importance were questions relating to future exchange relations of the three countries and the conversion by stabilization funds of foreign currencies into gold. He had emphasized repeatedly to the French that “we have not agreed to anything and we will not until this

¹⁰ Telegram No. 367, Morgenthau to Cochran, Sept. 23, 1936, *Foreign Relations of the United States*, 1936, Vol. 1, pp. 557-558.

¹¹ These margins implied a 13 per cent range for the franc of \$0.0435 to 0.0496.

question of rates is settled." Turning to gold conversion, Morgenthau said, "I told Bewley what I was willing to do in July, and I would be ready between now and midnight to give you my answer on that." Thereupon, he asked the British diplomats to return the same evening to receive a message on the exchange rates for the Chancellor.

A telephone call to Hyde Park found Roosevelt steadfast: a \$5.00 pound with margins of 10 cents on either side was "sine qua non." When Mallet and Chalkley returned, Morgenthau asked them to inform their government that the administration viewed the present sterling-dollar rate as "mutually satisfactory," that, in going ahead with the current negotiations, the United States was taking "for granted that we are talking about a \$5.00 pound," with margins of 10 cents in either direction and that "we would try to hold" the sterling-dollar rate between \$4.90 and \$5.10. The Secretary assumed that the Chancellor "feels as I do . . . but before we go any further we want to make sure that we understand each other." Morgenthau assured the British that everything he had told them had the President's approval. After the British departed, Morgenthau telephoned Cochran—it was 3:15 A.M. Paris time on Friday, September 25—to give him the substance of his message to Chamberlain and instructed him to inform the French. Cochran did so at 10:00 A.M., and Baumgartner—to whom he spoke—promised to instruct Mönick in London to urge the British to satisfy Morgenthau's request. With gold pouring out of France and the Council of Ministers scheduled to meet later that day to decide the fate of the franc, time was running out.

Chamberlain "went up in the air" when he heard that Auriol believed everything "had been settled" between the British and American Treasuries regarding the sterling-dollar rate, and it is a safe bet that he went up even higher when he read Morgenthau's message, which flatly contradicted British policy as cabled to Washington only eleven days earlier.¹² Since the Secretary had raised no question at that time, the British doubtless agreed with Mönick, who regarded Morgenthau's latest message as merely "a try-on." Any commitment to fixed exchange rates remained unacceptable. The British wished to avoid embarrassing the French, yet, even more, to avoid tying their own hands.

Accordingly, the Chancellor's reply included phrases intended to mollify the Americans but promised no change in the British policy. The Secretary was assured that it would continue to be the Chancellor's

intention not to intervene in the market in order deliberately to depreciate the pound. On the contrary, he would hope, if the need arose, to be able, as in the past, to check any landslide. While no one can foresee the precise rate at which the exchange can hold itself, the Chancellor would not expect, in the immediate

¹² See page 37 above.

future, such a heavy depreciation as would be likely to give the United Kingdom any competitive advantage.

While Chamberlain conceded that, in the new circumstances, \$5.00 might be the "natural level of the pound," he himself "would have expected it to be decidedly lower," especially if the flow of refugee capital that had been strengthening sterling for so long were reversed. In any event, he had "no legal power to fix the pound within gold points." Moreover, the interests of "national prosperity" required the British government, like that of the United States, to make no commitment for the future about exchange rates. Chamberlain was "convinced that any attempt to peg the pound artificially at an unnatural level would be both futile and contrary to the real interests of both countries."

Morgenthau could not have been very surprised at Chamberlain's response. Although his advisers had supported the attempt to commit the British to \$5.00, knowing that was the President's wish, some had felt the rate was too high. While the Secretary was still waiting for the British reply, Knoke told him that he would have been happier with \$4.95 and believed that the United States would not be hurt even by \$4.90. White thought sterling might fall to those levels as speculative funds returned to Paris after the devaluation but that the British would "hesitate to go lower, because they know our attitude. . . ."

On a more general plane, Williams told the Secretary that he believed "the British are not planning to play with us in this matter at all . . ." and that "it would clarify the situation if we would recognize that we have no real power over them at this stage. . . ." Indeed, shortly after he had given the message to the British, Morgenthau himself prepared the President for a disappointment, saying,

I am not at all hopeful about it because I think when we get down to the rate business the British will kick over the traces. The only thing that will bring them in is the desperate situation of France. They will kick about a \$5.00 pound.

In response to Morgenthau's question about the course to be taken if the British should "say between \$4.95 and \$4.86," White replied that the issuance of the declarations was more important than the attainment of the exchange-rate goals.

As it turned out, Roosevelt did not insist on a commitment from the British. In emphasizing that national prosperity took precedence over exchange stability, Chamberlain had struck a note that harmonized with the President's own ideas. On sterling-dollar rates he agreed to disagree. A note that Roosevelt dictated for Morgenthau's signature affirmed that the appropriate level of exchange rates was "a matter of opinion" and that

as long as Mr. Chamberlain understands that we believe the \$5.00 level to be the appropriate one, the future operations can be conducted after suitable conference and therefore reserving every right to state our position as it develops in the future and, without agreeing to Mr. Chamberlain's present thought of a lower rate between the dollar and the pound, the Secretary of the Treasury believes that this is not an obstacle which need prevent the issuance of the simultaneous statements in order to carry out their broad, useful and indeed essential objective.

The President felt the negotiations had gone so far that he did not want to stop them; there was too much at stake.

Negotiating dollar convertibility. Shifts in money flows after the French devaluation kept the question of the dollar's convertibility into gold very much alive. Despite the enactment of laws that deprived speculators of much of their expected profits, balances moved to Paris during most of October. As between Britain and France, the arrangements negotiated by Fournier and Cobbold came into operation when the Paris markets reopened on October 2. With the Bank of France buying sterling against francs at about 105, the French acquired £21 million in gold from the EEA during October. At the same time, the Bank of France was buying dollars but was unable automatically to convert them into gold; under U.S. Treasury regulations, the privilege was extended only to countries the value of whose currencies was fixed in terms of gold.

The convertibility problem had been foreseen by the French when they decided against devaluation "on gold" and chose rather to manage the foreign-exchange value of the franc between wide margins. It was likewise on the minds of the British but, anxious to avoid any stabilization commitment, they were reluctant to raise the question of converting dollars into gold directly with the United States. Instead, they successfully used France as a stalking horse in the convertibility negotiations. It was partly at Cobbold's instigation that Fournier raised the question with Cochran even before the publication of the declarations.¹³ Thereafter, when Fournier reported that no difficulties were expected in the arrangement of reciprocal conversion facilities between France and the United States, Cobbold emphasized that he regarded the establishment of such arrangements as extremely important. If the Americans were prepared to convert dollars into gold for France, the value of whose currency could fluctuate against gold within a thirteen per cent range, they would be in a weak position to insist that the privilege would be accorded to Britain only if sterling were confined to a 4 per cent range. Hopeful about the outcome, the British remained passive and let the French do the negotiating.

¹³ Telegram No. 908, Cochran to Morgenthau, Sept. 23, 1936, *Foreign Relations of the United States, 1936, Vol. 1, p. 555.*

In the light of Cobbold's remarks and the prospective accumulation of dollars, the French became increasingly anxious to settle the convertibility question. Shortly after the reopening of the Paris market, Cariguel asked Knoke whether dollars bought by the Bank of France would be convertible into gold, and Knoke promised to raise the question again with the Treasury. Morgenthau required no persuasion. As early as September 28, he had indicated that reciprocal conversion facilities would be arranged as soon as the French monetary law was enacted. In the two weeks that followed the enactment of this law by the French Parliament, there were consultations between Washington and London to arrange parallel facilities with the British.

If the failure of the attempt to extract an exchange-rate commitment from the British caused Morgenthau to have any doubts about extending convertibility privileges to them, these doubts disappeared soon after the reopening of the exchange markets. As some of his colleagues had predicted, the movement of international balances, which had been toward London before September 25, was now reversed, and sterling dropped to a range of \$4.90 to \$4.95 in the first half of October. After analysis, Morgenthau concluded that the decline was caused by market forces; the British were not manipulating the rate. On the contrary, they were acting in the full spirit of the Tripartite Agreement. Indeed, Morgenthau believed they had expended about three times as much in cushioning sterling's decline as the United States had. Discussing Britain's contribution to the management of the sterling-dollar rate with a group of senior administration officials on October 12, Morgenthau said: "She has absolutely kept good faith, and no one could ask for a better partner than we have had during the last couple of weeks."

In the light of this experience, Morgenthau felt that the spirit of the Tripartite Agreement required that convertibility facilities be extended to Britain at the same time as to France. Without discussion, he dropped his request for an explicit commitment by Britain on the sterling-dollar rate. He recognized that the British government, like his own, had to consider national opinion, which forbade the acceptance of any commitments that suggested a return to the bad old days of the gold standard. More important than explicit assurances was the fact that, in all three countries, the monetary authorities were attempting to stabilize the exchange markets, to discourage disturbing flows of speculative capital, and to create conditions conducive to the re-expansion of trade. The exchange markets would be managed under a gentleman's agreement. In any event, the United States itself would accept no long-term commitment. The \$35 price at which it agreed to sell gold was subject to change at twenty-four hours' notice. With recollections of the change in the U. S. gold price from

\$20.67 to \$35 still fresh, no reminder was necessary about retaliatory measures that the administration might take against foreign attempts to manipulate the exchanges to America's disadvantage.

Apart from such considerations, Morgenthau was confronted with the same problem as the Bank of France. In cushioning sterling's decline, the American stabilization fund acquired moderate balances in London. True, in anticipation of pressure against the pound, the Treasury, acting through the Federal Reserve Bank of New York, had on September 25 placed a standing order with the Bank of England to buy up to \$100 million of gold whenever the London price reached the sterling equivalent of \$34.77, which allowed for the cost of shipping and insurance between London and New York. However, this arrangement gave no assurance that sterling acquired through support purchases in New York could be converted into gold at the official price without driving up the London gold price and so further depreciating sterling's rate against the dollar. A few days after the Paris market reopened, Morgenthau was complaining: "I am buying sterling and I can't convert the damn stuff." He sympathized with the French: "No country wants to sit and hold paper." The convertibility assurances that Fournier wanted with respect to the dollar Morgenthau similarly wanted with respect to sterling.

With these considerations in mind, Morgenthau approached the British on October 5. He told Mallet and Chalkley that the Treasury was about to enter into an agreement with the French stabilization fund on reciprocal gold-conversion arrangements with prices to be determined from day to day. In the spirit of the Tripartite Agreement, he was willing to enter into corresponding arrangements with the British authorities.

With one fundamental exception, the proposed arrangements were virtually identical with those already in operation between the French and British central banks, about the main features of which the American authorities had been fully informed. This exception was, of course, that the price on the basis of which the United States would undertake gold transactions with foreign stabilization funds, while subject to change on twenty-four hours' notice, was expected in the absence of major economic upheavals to remain \$35. That price, Knoke observed, was "the pivot." Other countries, in contrast, were expected to maintain a fixed price for gold in terms of their own currencies only for short periods. Over longer intervals, their gold prices, while related to the \$35 price, would be determined in accordance with movements of their exchange rates against the dollar. By standing ready to sell gold at such prices, the French authorities, for example, would assure the American fund that support purchases of francs made at exchange rates at or lower than the temporary parity would be convertible into gold at no more than \$35 equivalent. The

same would apply to purchases of dollars by the French fund at times when the franc was at or above the temporary parity. No limit was to be placed either on the amount of conversions at an announced price or on changes in the gold price, which could be made hourly or even continuously during a day. Conversion of balances would, of course, be at the price in effect at the time of the currency purchase rather than at the time of conversion. Balances could be converted at any time up to twenty-four hours after purchase; the price applicable to conversion of balances held longer than twenty-four hours would be subject to negotiation.

With minor technical adjustments, these arrangements were satisfactory to the British. Accordingly, Morgenthau announced on October 12 appropriate changes in Treasury regulations to authorize sales of gold to the British and French at \$35 and invited other countries to enter into similar reciprocal arrangements. Through these arrangements, the Secretary told the press, responsible governments would cooperate to minimize the exchange risks faced by businessmen. Importers and exporters

will be free to operate through their respective banks in regular and normal exchange operations. The international speculator, responsible to no one and recognizing no flag in the conduct of his business, will in the future not be able by rapidly shifting his funds from market to market to reap private advantage through stimulating chaos in foreign exchanges.¹⁴

Probably more important, the administration could face the final weeks before the presidential election with some assurance that exchange disturbances, especially in the key sterling-dollar rate, would not upset America's economic recovery.

¹⁴ *New York Times*, Oct. 13, 1936.

V. CONCLUSION

With the establishment of these arrangements, the first step was taken toward the rebuilding of an international monetary system. Among the three democracies, no new conception had as yet challenged the classical theory of the gold standard. But the unhappy experience of the preceding decade had raised great skepticism about the practical operation of the classical system. Everywhere, the authorities resisted the re-establishment of the gold standard, insisting that conditions were not suitable and that unspecified reforms should be negotiated. Roosevelt, as has already been seen, rejected the classical system entirely.

In the absence of an accepted theoretical model, the rebuilding of the international monetary system proceeded on an ad hoc basis. The three years following the breakdown of the London conference had witnessed a host of problems, some of which were resolved under the Tripartite Agreement. Of key importance, of course, was the agreement to convert currencies into gold without limit at an agreed but changeable price, which eliminated exchange risk for the authorities within a framework of exchange-rate flexibility. In bringing international gold transfers more fully under government control, the new arrangements also eliminated the bottlenecks that, in times of crisis, had occurred in the private market's gold-transfer mechanism and had been handled only by impromptu official arrangements.

Of greater significance than these technical improvements was the resumption of international consultation on exchange-rate policy. The democracies were emerging from the period of unilateral action that began in September 1931. In considering the depreciation of the franc, the French authorities realized that the effectiveness of the realignment depended not only on domestic political support but also on the collaboration of their major trading partners. Knowing that Britain and the United States retained authority to change the value of their currencies in terms of gold, the French sought to protect themselves against further depreciation of sterling and the dollar. They likewise sought to safeguard themselves against the imposition of new trade restrictions such as France itself had adopted for protection against the depreciation of the British and American currencies. Accordingly, they limited their devaluation to an amount that, after consultation, they judged would be accepted by the United States and Britain.

The realization that exchange-rate policy has international ramifications did not end with the French devaluation. The arrangements negotiated

under the Tripartite Agreement assured continuing consultations. Telephone communication between central banks, which had been dormant for weeks on end in 1934 and 1935, was resumed on a frequent basis as exchange-market conditions and operations were discussed. Although each country claimed sovereign power to change its exchange rates in accordance with its domestic needs, the presumption in favor of stability was strengthened. The declaration published on September 25, 1936, had inveighed against "competitive depreciation," and in private the views of the authorities on exchange rates had been made known, even if no agreement on appropriate rates had been reached. In any case, the authorities understood that the gold-conversion privilege that protected them from exchange risk was subject to withdrawal in the event of serious disputes about exchange-rate movements. At least initially, the authorities were at pains to establish their good faith in exchange operations and to provide justification for such exchange-rate movements as occurred. A beginning was thus made to the still unfinished search for an agreed basis for exchange-rate policy.

Recognition that the international community has a legitimate concern with exchange rates was accompanied by a further significant step toward the stabilization of the gold price of the dollar and thus toward the central role that the United States would thereafter play in the monetary system. In return for managing the exchange markets in a manner that the Roosevelt administration would regard as reasonable, the participating monetary authorities obtained U.S. agreement to convert dollars into gold at \$35 per ounce. To be sure, that price was subject to change on twenty-four hours' notice, but the probability of such a change was becoming increasingly remote.

By the autumn of 1936, the economic recovery of the United States was well started, although still far from complete. The devaluation of the dollar was believed to have done as much as could be expected. The Tripartite Agreement had minimized the adverse movement of the exchanges against the dollar. Thereafter, a period of consolidation and calm was needed to provide further support for business confidence. In particular, further recovery required a reasonably stable exchange-rate structure, for which—as the Washington authorities came increasingly to believe—a necessary, though not sufficient, condition was the maintenance of a fixed gold price for the dollar.

While the \$35 gold price was becoming a semi-permanent feature of the international monetary scene, the attachment of the French to fixed exchange rates remained unchanged. The widening of the margins under the October 1, 1936, monetary law was employed initially, at least, only to shift the basis for managing the franc to sterling from gold and the dol-

lar. This shift was made because the British currency was believed to be playing at that time a far greater role than the American in France's external transactions. True to its inclinations, the Bank of France pegged the franc to sterling at about 105 from the reopening of the markets on October 2 until early March 1937, when new difficulties led to further depreciation against both sterling and the dollar. During this five-month period, the franc, thus pegged, fluctuated in relation to the dollar in approximately the same way as sterling.

Of the three currencies, sterling thus remained the only one on what today would be called a managed float. Even so, there is no evidence that Morgenthau was wrong in his confidence that the British were acting fully in accordance with the spirit of the Tripartite Agreement. His satisfaction at their resistance to downward pressure on sterling during October, when balances were moving back to Paris, has been noted. Thereafter, French domestic difficulties turned the balance against the franc, and the flow of gold from Paris to London was resumed. However, much of Britain's gain was lost to other countries, including the United States; the \$244 million rise in the combined gold holdings of the Bank of England and the EEA in the six months ended March 1937 was no more than might ordinarily be expected for seasonal reasons. In market operations, moreover, the float was tightly managed. During the six months immediately following the Tripartite Agreement, the range of fluctuations in the monthly average of daily sterling-dollar rates was only one-half of 1 per cent compared with 1.9 per cent in January-September 1936 and about 4 per cent in 1934 and 1935.¹

While the renewed willingness to collaborate on exchange-rate policy was a step forward, the Tripartite Agreement took the democracies only a little way toward the rebuilding of an international monetary system. The arrangements instituted in the autumn of 1936 lacked many features that had been commonplace five to ten years earlier. Then, the gold-standard conception had been generally accepted, although its application in practice had been twisted to meet national needs. In 1936, each country's interests, as interpreted by the government in power, was virtually the sole criterion for public policy.

With the disappearance of an accepted international monetary framework, it was probably inevitable that central bankers would be pushed from the key role they had played in the 1920s and early 1930s. Then, the management of the system was a technical task for banking experts versed in the mechanisms of the domestic and international money markets. Within this framework, individuals who often spent a lifetime in the same

¹ Board of Governors of the Federal Reserve System (1943, p. 681).

institution developed close working relations and sometimes lasting friendships with their colleagues abroad. They became deeply familiar with their functions and with each other. Even in 1936, much of this old intimacy remained, especially among European central bankers, but responsibility for international monetary affairs had by then been shifted to treasuries and ministries of finance, among whom relations, although sometimes approaching friendliness, were often dismally unsatisfactory. In contrast to the long friendship between Norman and Strong, Morgenthau never spoke to Chamberlain and spoke only once to Auriol on the trans-Atlantic telephone, in hilariously broken French. As advisers to cabinet ministers, central bankers continued to play an important role, but policy questions were for their political masters. The latter, unfortunately, were constrained by national political pressures that prevented the quantum leap toward the international monetary system that was to be established only eight years later.

The tragedy is that, but for the short-sighted nationalism that dominated the democracies, something approaching the Bretton Woods system might have been established in the late 1930s. The basic ideas for its institutions had already been published by Keynes. Harry White was already at the United States Treasury. The American administration that was to espouse Bretton Woods was at the height of its power. The widespread aversion at that time to any commitment to fixed exchange rates might even have ensured arrangements that, incorporating more latitude for exchange adjustments than the par-value system, would have proved more enduring than the system actually established in 1944. Yet the democracies settled for a modest move toward cooperation that, despite Morgenthau's hopes, did little to arrest the drift toward war. Only toward the end of the conflict, when at incalculable cost the illusions of the 1930s had been shattered, was it possible to summon the political vision and will to build another international monetary system.

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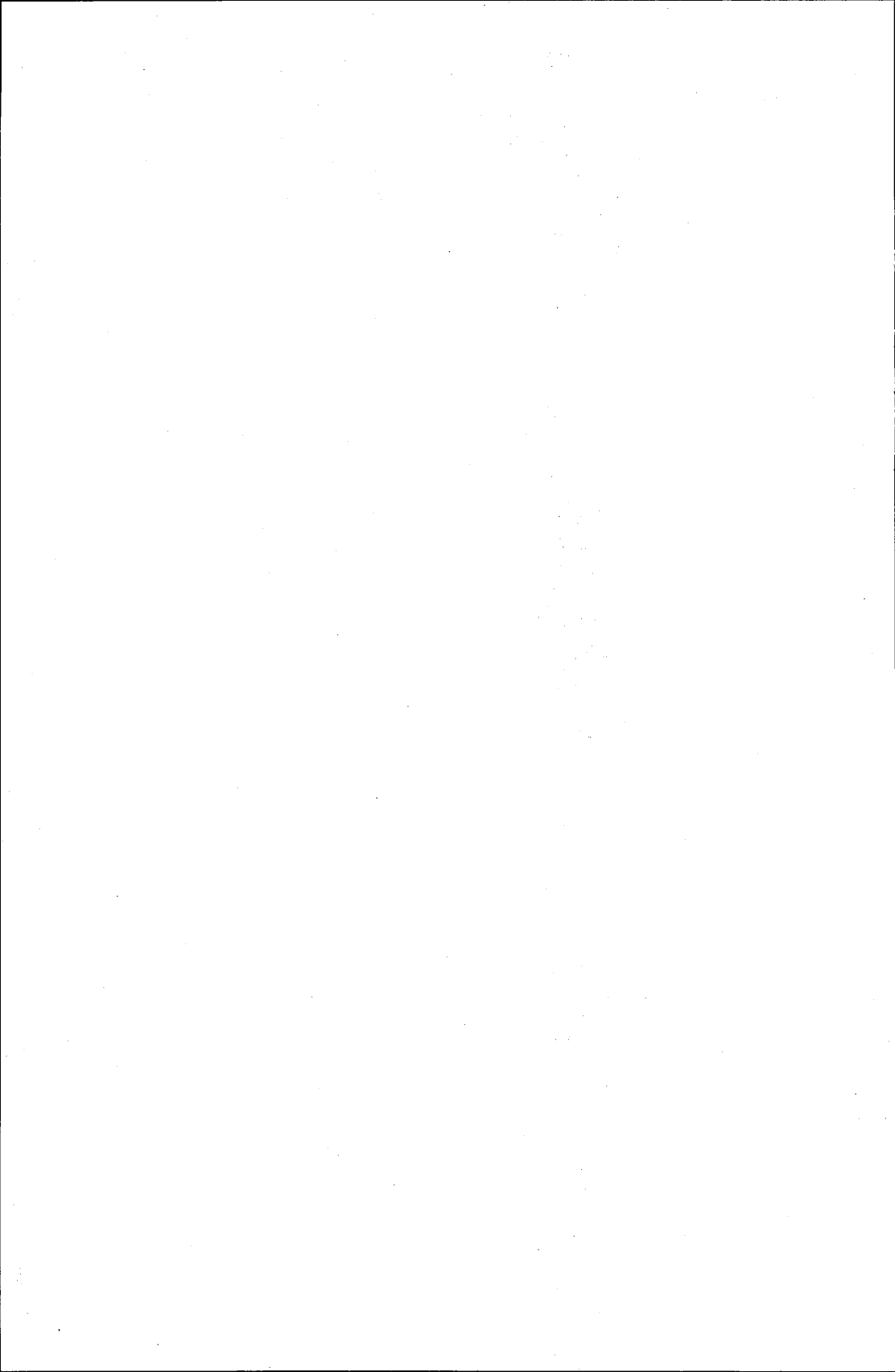
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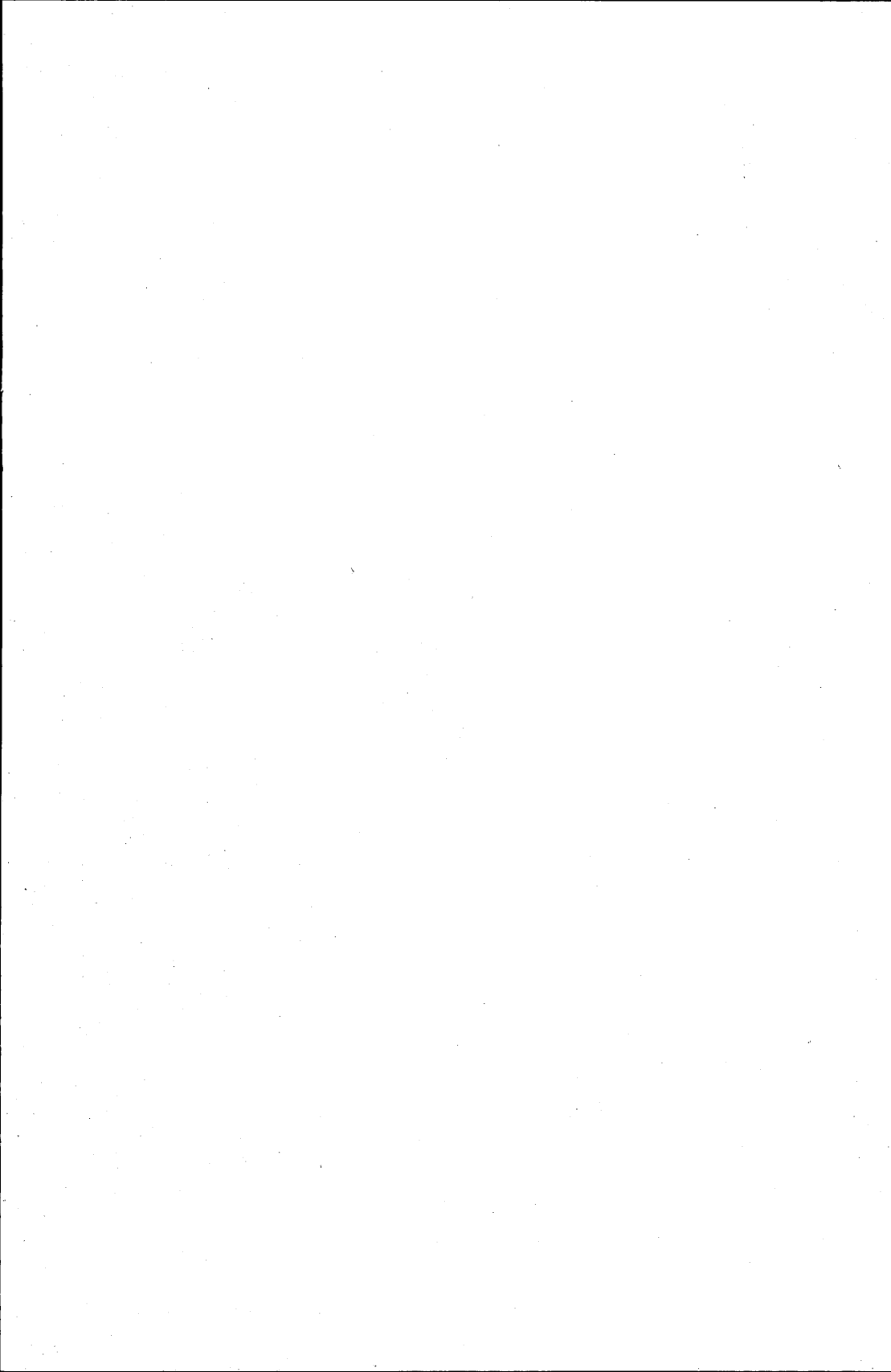
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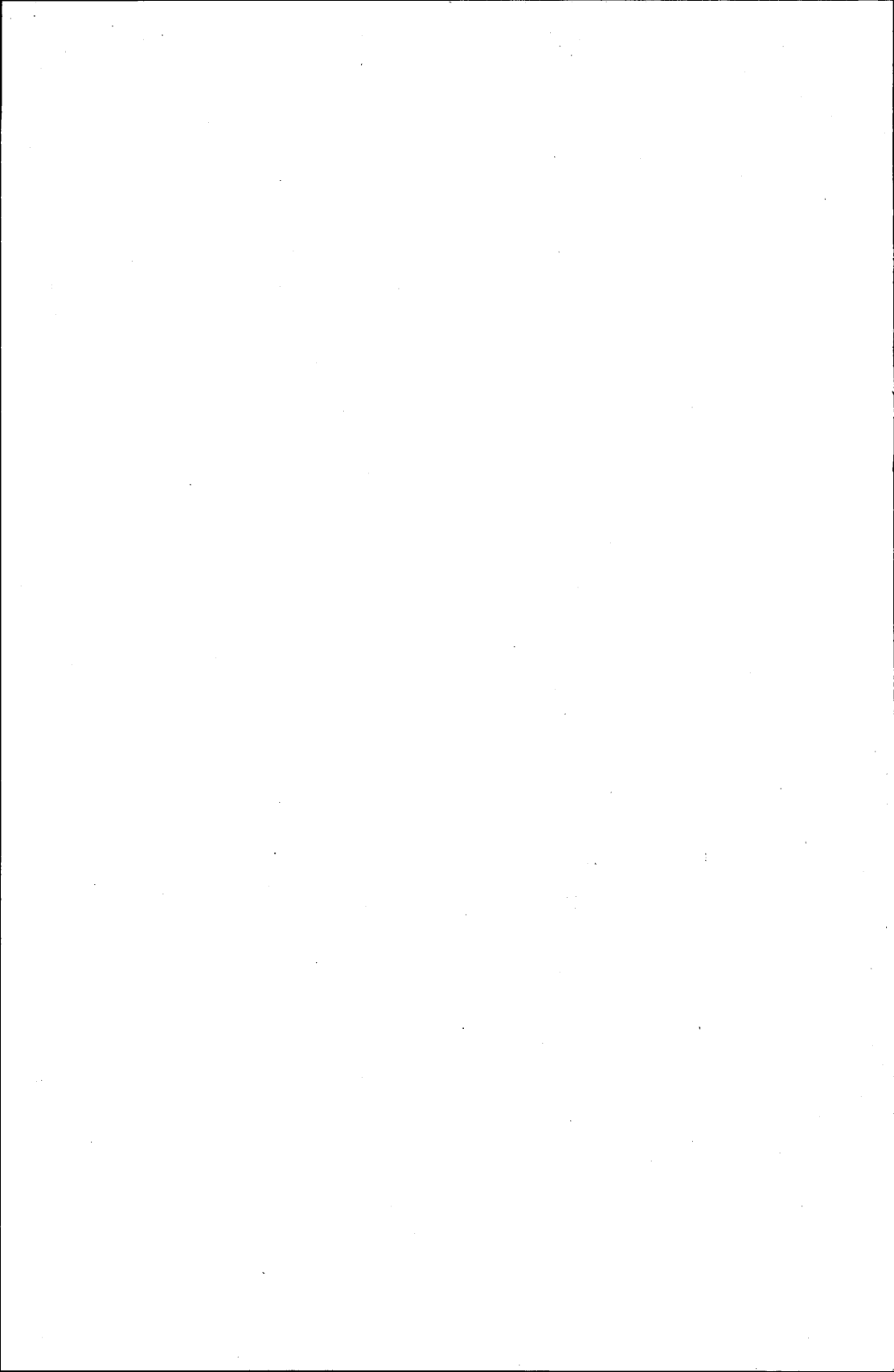
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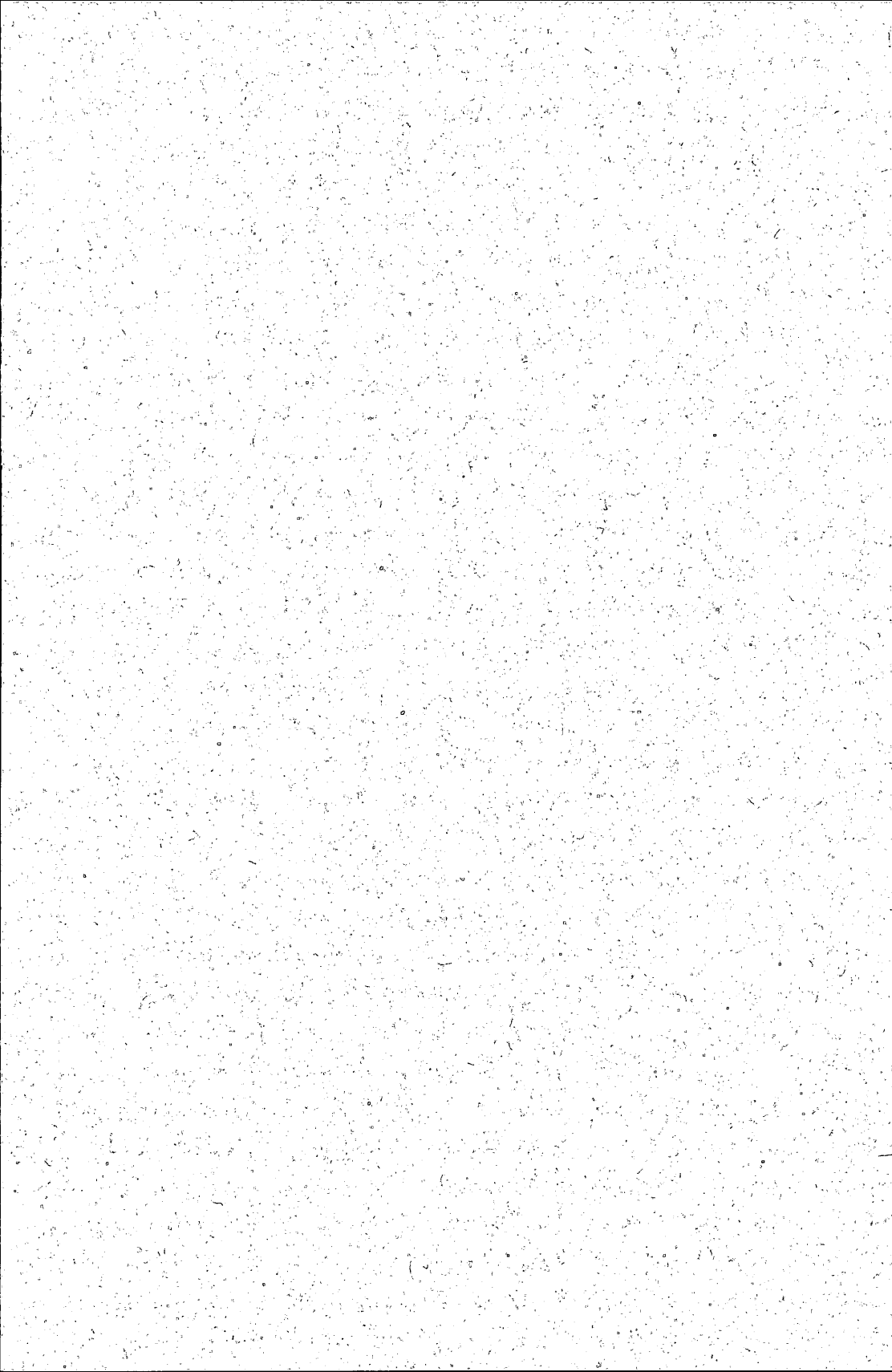
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