PRINCETON STUDIES IN INTERNATIONAL FINANCE NO. 45

London, Washington, and the Management of the Franc, 1936-39

Ian M. Drummond

INTERNATIONAL FINANCE SECTION
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CAST OF CHARACTERS

AURIOL, VINCENT, French Minister of Finance, June 1936-June 1937.

BEWLEY, THOMAS KENNETH, Financial Adviser to British Embassy in Washington, 1933-39.

BLUM, LÉON, French Premier, June 1936-June 1937, March 1938-April 1938.

BONNET, GEORGES, French Ambassador to Washington, 1936-37; Minister of Finance, June 1937-January 1938; Foreign Minister, 1938-39.

BULLITT, WILLIAM C., U.S. Ambassador to France, 1936-41.

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CHAMBERLAIN, NEVILLE, British Chancellor of the Exchequer, 1931-37; Prime Minister, 1937-40.

CHAUTEMPS, CAMILLE, French Premier, June 1937-March 1938.

COCHRAN, H. MERLE, Financial Secretary, U.S. Embassy in Paris, 1932-39.

DALADIER, EDOUARD, French Premier, April 1938-40.

FEIS, HERBERT, Economic Adviser to State Department, 1931-37; Adviser on International Economic Affairs, 1937-48.

HOPKINS, SIR RICHARD, Second Secretary of the British Treasury, 1932-42.

LABEYRIE, EMILE, Governor of the Bank of France, 1936-37.

LEITH-ROSS, SIR FREDERICK, Chief Economic Adviser to the British Government, 1932-46.

MARCHANDEAU, PAUL, French Minister of Finance, January 1938-November 1938.

MÖNICK, EMMANUEL, Financial Attaché to the French Embassy in Washington, 1930-34, in London 1934-40; Governor of the Bank of France, 1945-49.

MORGENTHAU, HENRY, JR., Secretary of the U.S. Treasury, 1934-45.

NORMAN, MONTAGU, Governor of the Bank of England, 1920-44.

PHILLIPS, SIR FREDERICK, Undersecretary of the British Treasury, 1932-40.

REYNAUD, PAUL, French Minister of Finance, November 1938-March 1940.

ROOSEVELT, FRANKLIN DELANO, President of the United States, 1933-45.

ROWE-DUTTON, ERNEST, Financial Adviser to the British Embassy in Paris, 1934-39.

RUEFF, JACQUES, Financial Attaché, French Embassy in London, 1930-36; Director, Mouvement Général des Fonds, 1936-39.

SIMON, SIR JOHN, British Chancellor of the Exchequer, 1937-40.

WHITE, HARRY DEXTER, Assistant Director, Division of Research and Statistics, U.S. Treasury, 1936-38; Director of Monetary Research, U.S. Treasury, 1938-41.

1 INTRODUCTION

The Tripartite Declarations

In the monetary history of the 1930s, 1936 was the "Year of the Tripartite Monetary Agreement." On September 25-26, 1936, the French, British, and American governments published almost identical declarations about their attitudes toward a desperately needed devaluation of the French franc and their desire for freer trade and fewer exchange restrictions. The British and American governments made certain promises to avoid retaliation against the French devaluation. Nothing was said, however, about the actual level of exchange rates, and there was no promise to stabilize rates over the long term.

We are generally told that the Tripartite Agreement brought new tranquillity and order into the monetary affairs of the Western world. The declarations are sometimes thought to have ended the chaos and disorder of the five years following the collapse of the gold standard in 1931. But an examination of the actual events of the period 1936-39 reveals no more tranquillity than in the period 1931-36. Sometimes the declarations are believed to have been a prelude to Bretton Woods, in that they established the principle that exchange rates were a matter of common concern. It is true that after the declarations there was almost continuous cooperation between the stabilization funds and central banks of Britain, France, and the United States. In accordance with the supplementary Gold Agreement, announced in October 1936, exchange rates were agreed on from day to day, and the three exchange funds cooperated in the management of the markets, settling balances daily in gold. This was the so-called "twenty-four-hour stabilization" of exchanges, an arrangement in which Belgium, Holland, and Switzerland soon joined. But the declarations established no mechanism by which countries could be compelled to consult before acting, because neither Britain nor France was prepared to admit that any other country or any process of negotiation could force on her the adoption of any particular exchange-rate regime. Thus the connection with Bretton Woods is tenuous at best.

This paper draws upon research materials that have been accumulated with the aid of travel and research grants from the University of Toronto and the Canada Council. This assistance is most gratefully acknowledged. Special thanks are due to Susan Howson, Donald Moggridge, David Dilks, and Robert Boyce, who have read successive drafts of the manuscript, and to the members of the Economic History Workshop of the University of Toronto, whose comments have helped to produce a better text.

Although some subsequent commentators recognized just how insubstantial these declarations were, others were misled by their own hopes and expectations, and the confusion has been spread by standard works of reference. Confusion was also occasioned by the fact that these three declarations were described as an "Agreement" almost from the moment of their issuance. (To avoid new confusion, I shall follow that imprecise practice.) As a result, the literature contains various statements that are either wrong or misleading.

Leith-Ross (1968, p. 170) tells us that the Tripartite Agreement was aimed at "limiting the fluctuations of the dollar, pound, and franc, and gradually restoring stable exchanges." Sir Frederick Leith-Ross was a senior U.K. Treasury official and Chief Economic Adviser to the Baldwin Government when the declarations were devised, and his statement reflects his own longing for stable exchanges, not the process by which the declarations were arrived at or the events thereafter. Lewis (1949) tells us that Britain, France, and the United States "signed a tripartite agreement not to alter exchange rates without consultation . . ." (p. 71), and that the "gold standard had not been restored, but the intentions and the consequences of the new arrangements were similar . . ." (p. 157). Lewis is wrong about both intentions and consequences. More recently, Strange (1976, p. 54) has told us that the accord was "partly to maintain the parity of the newly devalued franc by means of an exchange equalisation account" and partly "to regulate the sterling-dollar rate."[1] But France needed no Tripartite Agreement to create an exchange fund, and there was no new plan for regulating the price of sterling. Kindleberger (1973, pp. 257, 260, 261) has argued that although the accord committed the three governments to very little, it was a "significant step in rebuilding the international economic system" because "for the first time since 1933, exchange rates were discussed, technical arrangements made, and international co-operation built into the monetary area." Regrettably, it is hard to see much cooperation in the period 1936-39.

Clarke (1977) has recently traced the steps by which Britain, France, and the United States were led to issue the tripartite declarations. In so doing, he has shown how mixed were the motives that produced them, and his work serves to remind us that there was, strictly speaking, no agreement at all: Each government made its declaration for different reasons, and each had its own reservations and hidden assumptions. The terms of the three declarations had been harmonized until they were identical in essentials, but there was no

[1] Strange was citing League of Nations (1944), which apparently originated the confusion about the Agreement.

treaty and no single document to which the three powers adhered. Yet, until the outbreak of war in 1939, no one could deny that the declarations had in fact cohered into a sort of Agreement with which politicians and financiers were much preoccupied, both publicly and in private.

Historical Backdrop

Any study of the currency experiences of this period must consider the European political climate and the disturbing international developments of the late 1930s. Hitler's occupation of the Rhineland in March 1936, Italy's conquest of Ethiopia in May, and the start of the Spanish Civil War in July contributed to the general nervousness. These events were followed by Hitler's seizure of Austria in 1937, the Czechoslovakian crises of summer and autumn 1938, their temporary resolution at Munich, the German occupation of Bohemia and Moravia in spring 1939, and the darkening skies of July and August 1939 before the outbreak of war in September.

The statistical basis for both Britain and France is insufficient to support a fine-grained analysis of the effects of these developments on capital flows, but certain broad patterns emerge from what British data are available, and more can be learned from the opinions of the Whitehall officials of the period. First, because the European scene was growing steadily darker, there was a general tendency for funds to move across the Atlantic to the United States. Second, both Czech crises created severe difficulties for Whitehall and the Bank of England, with large capital outflows from Britain in 1938-39. Whatever respite was produced by the Munich settlement was brief and slight. In the summer of 1939, capital flows put the pound under such heavy pressure that the British were obliged to abandon their support operations in August 1939. Third, the French pattern was very different from the British. For the period from 1936 to 1938, when the franc was weak, it is impossible to separate the causes of French capital flight—fear of war, fear of increased spending on Popular Front programs, fear of currency confiscation or exchange control, and simple fear of the depreciating franc. One clue is that when the relatively conservative Daladier government came to power and established firmer financial control in the fall of 1938, reversing some of the Popular Front's more expensive projects and programs, funds returned to France even though the international scene continued to be threatening.

For the economist of the 1970s, accustomed to political stability, currency convertibility, and the study of interest-rate differentials, it is important to recall just how cheap money had become by the late

1930s. In 1938, for example, U.K. Treasury bills were yielding well under 1 per cent, and in other countries, too, money was earning little or no interest in that time of low economic activity. In such an environment, there was naturally more interest in protecting capital—in prospects for exchange rates and freedom to use and transfer funds—than in relative interest rates.

Attitudes toward Cooperation and Mutual Support

Having long believed that the franc was overvalued, British officials in September 1936 did not object to a French devaluation as long as it was not excessive relative to sterling, but they hoped for a reasonably stable franc thereafter. British documents do not tell us how Whitehall might have calculated that a devaluation was "excessive," either in 1936 or later. They do suggest that British officials were interested in movements of relative prices and wage rates but were skeptical about purchasing-power-parity calculations.

Neville Chamberlain, the British Chancellor of the Exchequer, and his officials insisted on avoiding any commitment with respect to the sterling-dollar rate, although London knew of Washington's hopes or expectations regarding that rate. In 1936 and thereafter, U.S. Secretary of the Treasury Henry Morgenthau, Jr., and President Franklin D. Roosevelt wanted a $5 pound. When sterling slipped below that figure in the course of 1938, they were worried, although they acquiesced eventually to a rate of $4.68, a rate that London determined unilaterally. As for the franc, Washington was more concerned about stability than about the precise level. American documents do not tell us how the President and the Secretary of the Treasury formed their opinions about target rates for sterling or for the franc during the period 1936-39. At best, one can detect a fear that if sterling were to fall to or below $4.86 there would be trouble in Congress, and probably pressure on commodity prices as well. For Morgenthau, politics were far more important than economics insofar as the franc was concerned. His advisers told him that the franc-dollar rate mattered very little for American recovery or trade. He believed that by helping the French to devalue in an orderly way he was strengthening not only the French government but also the forces of democracy in Western Europe. His beliefs survived the manifold disappointments of the period.

In 1936 neither Britain nor the United States was prepared to consider a common fund or mutual credit system by which exchange rates could be supported. Although the U.S. government could not legally have provided such credits to governments that were in default on outstanding debts to the United States, there were no legal barriers to credits among central banks. But when such credits were proposed in 1937, Morgenthau would not hear of them. Nor does it appear that France expected credits or asked for any in 1936. Clearly, Britain was not prepared to support the franc. As time passed, the British and American authorities became slightly more willing to provide credit to the hard-pressed French, who certainly became much more willing to ask. Yet little was done, and the credit proposals of 1937-38 were not large or systematic enough to help the French authorities very much.

By late summer 1936, when devaluation appeared inevitable, France was worried chiefly about the risk of offsetting devaluations—by Britain against the dollar and by the United States against gold. When the declarations of 1936 say that no country will attempt "to obtain an unreasonable competitive advantage," they reflect this French concern, from which the declarations had sprung in the first place. In Britain, it was believed that the United States had taken an unfair competitive advantage in 1933-34 and that Roosevelt was anxious to retain that advantage. Hence the British continued to worry about American gold policy. Whitehall always wondered whether Roosevelt or the Congress would raise the dollar price of gold should sterling fall. Britain did not believe that the United States could be trusted to honor any commitment about competitive devaluation, and the evidence suggests that in this respect Whitehall expected nothing from the Tripartite Agreement. On their part, Chamberlain and his officials maintained that Britain had never deliberately depreciated the pound, and so could not properly be accused of seeking unfair competitive advantage. Therefore, the Whitehall view was that the 1936 declarations involved no new commitments with respect to the management of sterling. Washington did not accept London's view of the management of sterling from 1931 to 1936, and when sterling depreciated sharply in 1938 both Morgenthau and his staff, especially Harry Dexter White, found their suspicions renewed. Thus Morgenthau valued the Tripartite Agreement because it would give the Americans grounds for complaint if sterling were to fall.[2]

At the time of the Tripartite Agreement, the vehicles for cooperation and discussion were the international telegraph, to a certain extent visits to Basel and to the several capitals, and sparingly the trans-Atlantic telephone. The three central banks were in daily touch. In

[2] The above paragraphs draw on Clarke (1977) and on my own researches, which will be published in Chaps. 9 and 10 of Drummond (forthcoming).

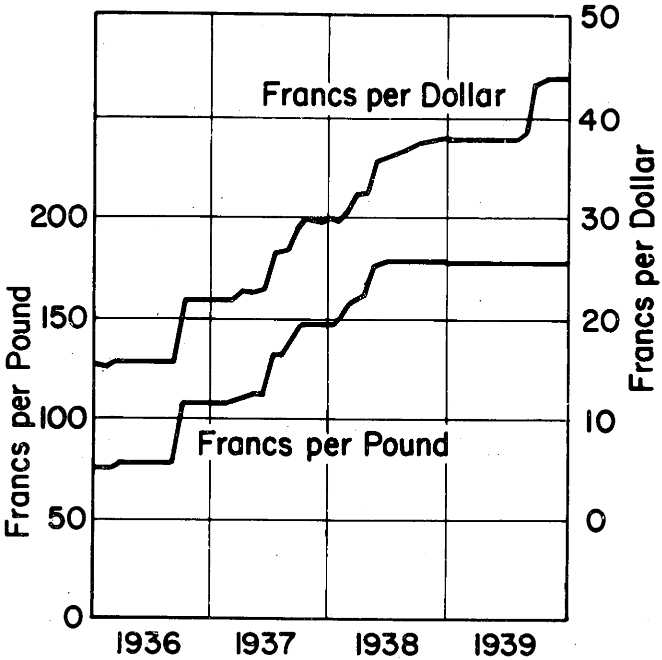
accordance with the Gold Agreement, each day it was necessary to send information about buying and selling rates, first from Paris to London and then to New York, as each capital successively took over management of the exchanges. Increasingly, long-distance telephone calls were used to pass on more general information about market prospects and local developments.

From London and Paris, the central-bank governors went almost monthly to the Bank for International Settlements in Basel. Although the United States was not a member of the BIS, H. Merle Cochran of the U.S. embassy in Paris regularly attended and reported his conversations in detail to his superiors in Washington. In addition, Cochran was Morgenthau's personal representative in Paris, where he was on good terms with politicians, officials, and bankers. W. Butterworth performed a rather similar function for the United States in London, though he worked rather more closely with his embassy. In Paris, the British Treasury had Ernest Rowe-Dutton, and in Washington, most of the time, T. Kenneth Bewley. France relied heavily on Emmanuel Mönick, who was a permanent financial attaché, sometimes in Washington and sometimes in London. These financial attachés and representatives were far more important than the ambassadors. They had access to officials and central bankers; they communicated directly with their home Treasuries; they informed themselves about financial affairs more completely than any ambassador could hope to do. Ambassadors entered the picture only when some fairly formal act was required and when the relevant attaché was unavailable.

France's new monetary law of October 1, 1936, allowed the franc to vary between 43 and 49 milligrams' worth of gold. Since the American dollar was linked to gold and the pound was not, it might seem that the franc was pegged loosely to the dollar. From September 1936 until September 1939, however, the franc-sterling rate was the rate the French authorities watched, not the franc-dollar rate, and they pegged it more or less rigidly for extended periods (see the accompanying chart). Their new monetary law survived only to the end of June 1937, and during these first nine months of the new regime, the sterling-dollar rate stayed within a narrow range. Thus, they could easily fix their attention on the franc-sterling rate while remaining within the law. By the time sterling began to weaken in the autumn of 1938, the French monetary law had been changed once more, and so the franc could go down not only relative to sterling but with it.

In the winter of 1936-37, exchange rates were relatively stable, because the French authorities were spending gold to support a weak franc while the British were buying gold to hold down a strong pound.

FRANC-STERLING AND FRANC-DOLLAR EXCHANGE RATES,
MONTHLY AVERAGES, 1936-39



SOURCE: *Annuaires Statistiques de la France.*

But in the spring of 1937, the franc began to sag, moving downward relative to sterling from April 1937 until May 1938. Sterling fell from $5.00 in July 1938 to $4.60 during the Munich crisis, recovered to over $4.80, and then slipped once more, ending 1938 at around $4.68. With respect to exchange stability, in other words, the record of 1937-38 is not exactly splendid. Without the Tripartite Agreement, however, the French might have felt free to let the franc drop farther, faster, or more irregularly. The Agreement at least gave Britain and the United States a license to remonstrate.

From November 1938 until after the end of August 1939, France was able to do what Britain had done from 1935 to 1938. The franc was strong once more and gold was flowing in, but the French authorities did not let the franc appreciate relative to sterling; instead, they systematically rebuilt their gold reserves. During this period, the sterling-dollar rate also changed remarkably little. But whereas the franc was strong, sterling was weak; whereas the French authorities heaped up gold, the British spent it to stabilize the sterling-dollar rate at \$4.68. Examining the exchange movements of these months, the casual observer might think that indeed the Tripartite Agreement had produced a new era of stability. But it is hard to see how the declarations, as such, had much to do with this last prewar interval of stability in 1938-39. The strong franc was stable because France's authorities did not want it to appreciate; the weak pound was stable because Britain's authorities did not want it to depreciate. Britain did not ask for Franco-American credits to help her authorities support the pound. The Tripartite Agreement was relevant only insofar as it made the British authorities more nervous about American reaction to a sinking pound. But they would have been nervous anyway, and in autumn 1938 they let sterling fall without asking permission either of Washington or of Paris.

The present paper is concerned less with the cooperation among central banks that made the exchanges seem so much more orderly after September 1936 than with tracing the symptoms of longer-run disorder. To this end, it concentrates on the behavior of the French authorities and on reactions in London and Washington. Although there is no systematic discussion of the management of sterling,[3] the evidence presented here should be enough to reveal just how incomplete and spasmodic were the cooperation and consultation that followed the Agreement.

[3] The management of sterling is not treated here partly because Sayers (1976) has recently discussed it and Howson (forthcoming) treats Britain's Exchange Equalisation Account, and partly because I include a discussion of sterling in Drummond (forthcoming). A discussion of the financial diplomacy of sterling between 1936 and 1939 would need a paper as long as this one.

2 BLUM AND AURIOL[1]

By the summer of 1936, political pressures on the franc were at least as important as economic ones. The actions and policies of the Popular Front government, headed by the Socialist, Léon Blum, alarmed French capitalists. The Tripartite Agreement did nothing to prevent the recurrence of such fears in later years, provoking further capital flows from time to time. Such flows made others fear a weakening of the franc, and the result was an additional capital exodus whose immediate motivation was more strictly economic. The international political scene was an additional source of disturbance. These were times when no amount of domestic "pacification" and no degree of confidence in the franc's future could have prevented the nervous from moving their money to Britain or the United States. In the background, too, was the possibility of exchange control. Successive French Premiers and Finance Ministers proclaimed their abhorrence of this device, but everyone knew that certain political forces, especially on the left, wished to introduce it. At any time, circumstances might oblige right-minded men to give way, or bring wrong-minded men to power. The prudent, therefore, would sell francs sooner rather than later.

In autumn 1936, British officials hoped that Premier Blum and Minister of Finance Vincent Auriol would devalue the franc in a clear-cut way that would preserve the gold standard and induce a reflux of French capital. They wanted France to devalue enough to convince capitalists that the new rate could be maintained, and to attach the franc to gold so as to convince the nervous that French money was worth holding. Since French funds had flowed partly to London, any such reflux would be partly at the expense of British gold reserves, but the British authorities were prepared to shed equal amounts of gold assets and short-term liabilities for this purpose. On October 2, after negotiations between the British and the French, the franc opened at

[1] These chapters are based on archival researches in Britain and the United States. Among the materials that have been drawn upon are the Morgenthau Diaries in the Roosevelt Library at Hyde Park, the Neville Chamberlain Papers at the University of Birmingham, and various holdings in the U.K. Public Record Office, London. The annual volumes of *Foreign Relations of the United States* have also been used extensively. In the notes that follow, "MD" refers to the Morgenthau Diaries, followed by the volume number. References to materials in the Public Record Office employ the appropriate archival key letters—"CAB" for Cabinet papers and minutes, "FO" for Foreign Office records, and "T" for Treasury records. The Neville Chamberlain Papers are identified by "NC," and *Foreign Relations of the United States* by "FRUS."