The Changing Gold Exchange Standard and the Role of the International Monetary Fund*

The gold exchange standard, considered as a set of institutional arrangements, attitudes, and operating techniques, has developed a great deal in recent years. This paper discusses a number of recent developments, and argues that these have created a gold exchange standard which in many ways functions differently than the older one. Moreover, since further developments are on the horizon, the gold exchange standard a decade hence is likely to operate in a substantially different way than it does today. For it would be unreasonable to expect that international financial arrangements will not change when the world and its financial requirements change.

It is not, however, easy to describe the present situation with great accuracy when many changes are taking place and full reports on some of them are not available. Moreover, in trying to do so, it is necessary to maintain a balance between two views, both of which have elements of truth. One view is that there have not really been any new developments, since a precedent can be found for every one. The other view is that the conditions in the postwar (as in every historical epoch) have been unique, and that these conditions have been met by developments which are new to such an extent that precedents are only of academic interest.

I

The gold exchange standard has developed over a long period. It was not invented at the Genoa Conference in 1922. Before 1914, many European central banks had held some portion of their reserves

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* The views expressed in this paper are personal, and are not necessarily those of the International Monetary Fund. Part of this paper is an expansion of a seminar given at the University of Zurich in 1962.

in foreign exchange and many underdeveloped countries were on a gold or a silver exchange standard (1).

The gold exchange standard at the present time can best be appreciated in the light of adaptations to the problems that have emerged since the end of the Second World War, and most recently, since 1958.

The breakdown of the international financial system in the 1930's with the emergence of currency blocs and the virtual disappearance of long-term foreign investment has become a memory. The trends to deflation, competitive devaluation, and autarchy have been drastically reversed. For approximately the first decade after the war, the world struggled with inflation; for the last few years, the major industrial countries have been concerned with price stability. In the next few years, the major industrial countries will probably be concerned with policies required to maintain growth and full employment. These policies will concern price levels required to maintain international and domestic competitiveness; profit margins appropriate to high levels of investment and growth; redirections of trade incident to the development of supranational groupings (such as the Common Market), and the greater trading role of communist bloc countries; provision of resources for economic development; and terms of trade that will be fair to underdeveloped countries.

The international flow of long-term capital has increased substantially. The flow from public sources, in the form of government aid, grants, and long-term credits, is accompanied on a growing scale by that from private sources, in the form of direct investment, portfolio investment, and short-term banking credits. Markets for short-term capital have become large and active, and rates in individual markets are rapidly being adjusted to each other. Markets for Euro-dollars and other foreign currencies have grown in about

(1) A. I. Bloomfield has noted that " the pre-1914 gold standard was far from the simple and uniform thing it is often supposed to have been " and that it included " countries on a wide variety of forms of the ' gold exchange standard ', such as Russia, Japan, Austria-Hungary, the Netherlands, most of the Scandinavian countries, Canada, South Africa, Australia, New Zealand — all of which held a substantial part or the bulk of their external reserves in foreign exchange — and, in a peculiarly rigid form, India, the Philippines, and a number of other Asiatic and Latin American countries, whose currency systems operated analogously to modern currency boards " [*Monetary Policy Under The International Gold Standard, 1880-1914* (1959), p. 14].

five years to a total of $4-5 billion (2). Private long-term capital markets, operating with more and more freedom, have re-emerged in practically all of the industrial countries.

Exchange controls and restrictions have been reduced almost everywhere, and in many industrial countries have been largely or completly dismantled (3). The major European countries achieved *de facto* external convertibility of their currencies in 1958, and *de jure* external convertibility (under Article VIII of the International Monetary Fund Agreement) in 1961.

II

These financial developments have had many desirable effects on the world system of trade, payments, and capital movements, but have created a number of disturbing problems. The same freedoms that facilitated short-term and long-term capital movements have made possible greater speculation against any one currency, or against all currencies, and have made it more difficult for any country to maintain in the 1960's as independent a monetary and interest rate policy as it had in the 1950's.

Swings in the balance of payments of most countries almost always involve short-term capital movements to some extent. Since 1958, however, such capital movements among the major industrial countries have been a major disturbing element in the balance of payments. Consequently, strong efforts have been made since 1958 to deal with these capital movements and to prevent their damaging the stability and the smooth working of the gold exchange standard. These efforts have involved: 1) limiting short-term capital movements, without recourse to exchange or capital controls; 2) financing large capital movements through the cooperative efforts of debtors and creditors, to minimize effects upon international reserves; and 3) developing supplements to reserves in the form of gold, dollars, and sterling. These efforts, which have modified the workings of the gold exchange standard, are the subject of this paper.

(2) O. L. Altman, " Canadian Markets for U.S. Dollars ", and " Recent Developments in Foreign Markets for Dollars and Other Currencies ", IMF *Staff Papers*, November 1962 and March 1963.

(3) See the general survey in the International Monetary Fund's *Annual Report on Exchange Restrictions*, 1962.

Short-term capital moved in response to interest rate differentials and for speculative reasons. Some interest rate differentials had gradually developed because of exchange controls, restrictions, and limitations on convertibility before 1959. Others were created for limited periods by monetary policy, e.g., the restriction of domestic liquidity by Germany in 1960, the increase of Bank Rate to 7 per cent in the United Kingdom in the third quarter of 1961, and the increase of the Canadian discount rate to 6 per cent in the second quarter of 1962. Short-term capital also moved in large amounts for speculative reasons, e.g., that the deutsche mark and the Swiss franc might be appreciated following the revaluation of the former by 5 per cent in March 1961. Moreover, capital moved at various times in response to expectations that sterling and the dollar might be devalued.

To complicate the situation further, some capital movements for interest arbitrage were covered while others were uncovered. In some cases, the lack of forward cover signified speculation; while in others, it represented a judgment that the structure of exchange rates was firm, as when guilders and other continental currencies moved into sterling in 1959 and 1960.

In normal circumstances, the movement of the forward rate in relation to the spot rate might have been quick enough and large enough to shut off these short-term capital movements. But the circumstances since 1958 have often been abnormal and the monetary authorities have from time to time found it desirable to intervene on a scale that was much larger than usual.

International cooperation to deal with capital movements has clearly been more rapid and extensive than cooperation to cope with surpluses and deficits in other components of the balance of payments. Cooperation with respect to money flows is generally easier than with respect to trade. Moreover, swings in capital movements were very large, and they had dangerous potentialities for growing larger by feeding on themselves. They could threaten the structure of exchange rates and reserves. Countries receiving such short-term funds recognized that they acquired a volatile asset of doubtful, if not negative, value; they had to face the prospect that capital could move out as rapidly as it had moved in. From the point of view of the receiving countries, the worst outcome would be to permit a long-term worsening of their trade balance because of a short-term inflow of foreign capital. They wished, therefore, to insulate domestic

prices, costs, and liquidity from such capital movements. Clearly it was to the best interests of all countries to reduce movements of short-term capital to " reasonable " amounts (4).

Intervention to reduce or eliminate movements of short-term capital, and finance the residual with a minimum drain on reported reserves proceeded on three fronts (5):

1) to reduce capital movements by supporting the forward exchange rate (6), and by coordinating national interest rate policies (7);

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(4) The word " reasonable " is vague but implies amounts that would not create large, cumulative disturbances. Problem-creating disturbances would include those that resulted in (a) large movements of reported reserves; (b) forward exchange discounts large enough to cast doubt upon the exchange parity and to throw a large volume of normal forward cover operations into the spot exchange market; and (c) serious problems for the recipient countries to neutralize or sterilize the inflow of capital.

(5) Cf. the more complete list of activities designed to rebalance the situation in the Fund's *Annual Report*, 1961, pp. 7-10.

(6) The policy of intervening in the forward exchange markets is not new. Thus, Keynes recommended that the Bank of England intervene systematically so that, on a temporary basis, short-term interest rates could be materially different in one financial center than in another. He would have employed two instruments, apart from Bank Rate: changing the buying and selling price of gold within the over-all (and somewhat wide limits) of 2 per cent; and setting the rates for forward exchange. [See *A Tract on Monetary Reform* (1923), Chap. V, Sec. 3, and pp. 132-139; and *A Treatise on Money* (1930), Chap. 36, Sec. iii]. But his discussion was based wholly on interest arbitrage considerations. Speculations about exchange parities were not a factor. Keynes' illustrations involved the case where one financial center wished to increase the differential between its short-term interest rates and those in another center, without either gaining or losing gold. The situations described in this paper differed because they had a strong speculative admixture.

The United States intervened in the forward market as an alternative to raising its short-term interest rate. Such an increase would have widened the interest rate differential between the United States, on the one hand, and Germany and Switzerland, on the other. The latter countries, it should be noted, maintained two sets of short-term rates on deposits: one for residents and the other for foreigners. Switzerland at times had negative rates on foreign deposits.

(7) This paper does not deal with interest rate coordination, which has not shown any striking new developments in recent years. It may be noted, however, that actions by countries with respect to interest rates were less coordinated than with respect to forward exchange rates.

The United States and the United Kingdom, the two major countries with weaknesses in their balance of payments in the last few years, have had somewhat different policies. The United States attempted to keep its long-term rates stable and increase its short-term rates. The objective was modest and was designed to slow down capital outflows. The United Kingdom has had relatively high rates, especially after the increase in Bank Rate to 7 per cent in 1961. These wese designed to discourge speculation against sterling and encourage inflows. Switzerland and Germany, which received large amounts of speculative capital, have paid low and occasionally negative rates of interest on nonresident short-term capital, but Germany in 1960 tried to increase rates while it had a capital inflow.

In 1961 and 1962, the United States continued to be a large supplier of both short- and long-term credit, in part because of its interest rate policy. As the Federal Reserve Bank of

2) to finance capital movements by supplementing the owned reserves of the country of origin by loans from the recipient countries, thus "recycling" reserves, and by drawings from the Fund;

3) to finance capital movements by developing additional reserves, which might supplement gold in settling balance of payments deficits.

The most publicized actions with respect to forward exchange rates were those of the United States, and counterpart foreign monetary authorities, to support the forward rate for dollars in 1961-62 (8). For when the discount on forward dollars exceeded the interest cost of borrowing dollars, a foreign exporter invoicing in dollars (say, a German exporter) would cover his dollar position by buying deutsche mark spot with dollars borrowed in New York or the Euro-dollar market. Buying spot deutsche mark with borrowed dollars gave him the same protection as selling dollars forward, but at a lower cost. When the discount on forward dollars was reduced, commercial covering moved back into the forward exchange market. Similarly, speculators found it cheaper to use the forward market rather than the spot market. Thus, support of the forward rate reduced the pressure on the spot rate, and it reduced, or at least postponed, the outflow of capital and of gold.

Foreign currencies used in, or required for, these interventions were arranged in three ways. The United States concluded $1.1 billion of stand-by swap agreements with foreign monetary authorities through January 17, 1963. These agreements could be drawn upon by either party to exchange dollars for foreign currencies (principally deutsche mark, Swiss francs, guilders, and lire), with the understanding that the exchange would be reversed later, usually in three

New York commented, "in several countries with large payments surpluses the outflow of capital was held back by relatively high interest rates and by the continuation of direct controls... Much remained to be done, therefore, in relaxing such restrictions and in achieving the appropriate balance of interest rates among the major industrial countries" (*Annual Report*, 1962, p. 34).

(8) A recent study notes that "during speculative periods, the Bank of England has not supported the forward market", and that specifically in the summer of 1961, when sterling was under heavy pressure, "there was no doubt that the Bank of England was actively supporting the pound [spot]... but there was no evidence of official support in the forward market". J. L. Stein, *The Nature and Efficiency of the Foreign Exchange Market*, Princeton Essays in International Finance, No. 40 (1962), pp. 37, 42.

months. Total drawings under these stand-bys have exceeded $600 million (9). The United States also acquired foreign currencies by direct borrowing. Finally, in several cases, the United States asked for and obtained payment (or prepayment) of foreign debts in foreign currencies rather than in dollars. U.S. monetary authorities first acquired holdings of convertible foreign currencies in April 1961. These holdings reached a peak of $550 million in June 1962 and stood at $132 million in April 1963 (10).

The United States bought some spot dollars with foreign currencies, thus supporting the spot rate, but it held most of its foreign currencies in reserve against forward purchases of dollars. Forward exchange operations were on a large scale. Outstanding commitments in deutsche mark reached a peak of $340 million in June 1961 (11); commitments in forward Swiss francs reached a peak of $153 million in November 1961 (12). Total forward exchange in deutsche mark, Swiss francs, Netherlands guilders, and Italian lire were about $1.5 billion in the 14 months ending May 1962 (13). Some of these contracts were allowed to run off, others were paid with borrowed foreign exchange, and the balance (especially some contracts in deutsche mark) were liquidated with foreign exchange bought in the open market.

Forward operations in dollars had the additional effect of forestalling conversion into gold by some existing dollar balances by some official holders. In turn, the Bundesbank, the Bank of Italy, and the Swiss National Bank engaged in swap operations with their commercial banks, selling spot dollars against local currency, and simultaneously arranging for repurchasing these dollars at forward rates favorable to the commercial banks. The European central banks undertook some exchange risks in making these forward commitments, but part of these were shared by the U.S. Treasury (14). One

(9) Charles A. Coombs, "Treasury and Federal Reserve Foreign Exchange Operations", Federal Reserve Bank of New York, *Monthly Review*, March 1963, p. 39. See also William McChesney Martin, Jr., "Monetary Policy and International Payments", Federal Reserve Bank of New York, *Monthly Review*, January 1963, p. 13.

(10) U.S. Treasury Department, *Treasury Bulletin*, May 1963, p. 79. These include the holdings of both the U.S. Treasury and the Federal Reserve System.

(11) *Federal Reserve Bulletin*, September 1962, p. 1141.

(12) *Federal Reserve Bulletin*, September 1962, p. 1144.

(13) IMF, *Annual Report*, 1962, p. 100.

(14) Charles A. Coombs, *loc. cit.*, pp. 42-43.

by-product of these arrangements was to increase the flow of dollars into the Euro-dollar market.

These operations in forward exchange undoubtedly forestalled large movements of capital and reduced the conversion of sizable existing dollar balances.

Drawings under swap transactions (reciprocal currency agreements negotiated by the United States with other central banks) could be used to the same effect. Thus, the two most important effects of these drawings have been described as follows:

> When the Federal Reserve initiates a drawing under a swap, it acquires a convertible currency that can provide temporary resources for exchange market operations. In what has been a more typical use, it can purchase from a central bank dollars in excess of those that the bank would ordinarily hold, in effect absorbing or mopping up these dollars for the period of the swap. Such an operation leaves the total dollar holdings of the foreign country unaffected, but it substitutes dollars sold forward to the Federal Reserve for dollars held "outright" — without such exchange cover. Therefore, the Federal Reserve use of swap facilities can provide a temporary alternative to an enlargement of outright dollar holdings of foreign central banks beyond the point at which conversion into gold would become likely (15).

The Swiss National Bank has explained that these transactions enable the central banks in question to hold part of their dollar reserves on a covered-forward basis, an arrangement which makes it unnecessary to convert these dollars into gold (16).

In addition to funds involved in swap transactions between the Federal Reserve System and other central banks, the U.S. Treasury reduced foreign-owned liquid dollar balances by selling foreign governments special nonmarketable issues of certificates, notes, and bonds. By May 31, 1963, these issues totaled $1,238 million, of which $608 million were denominated in dollars and $630 million were denominated in foreign currencies. Four countries held the latter, with the holdings of each denominated in its own currency (17).

(15) Charles A. Coombs, *loc. cit.*, p. 39. See also the Federal Reserve Board, *Annual Report*, 1962, pp. 39-44, and Federal Reserve Bank of New York, *Annual Report*, 1962, pp. 30-34.

(16) *Rapport*, 1962, p. 4.

(17) *Daily Statement of the U.S. Treasury*, May 31, 1963.

Austria	$ 25 million
Belgium	$ 30 "
Germany	$200 "
Italy	$200 "
Switzerland	$175 "
	$630 million

In the foreign currency series, the maturities ranged from six months to two years, with interest rates between 2.00 per cent and 3.27 per cent.

The redemption options applicable to these securities are very flexible. Those denominated in dollars with maturities up to six months are redeemable at the option of the owner on two days' notice. The largest security issue denominated in dollars has a term of 15 months, and can be converted upon two days' notice into three months' securities. Most of these securities, whether denominated in dollars or in foreign currency, with a maturity of more than three months, are convertible upon two days' notice into similar securities with a maturity of three months. The latter, at the owner's option, are redeemable upon two days' notice.

III

The technical details of these financial arrangements are complex, and vary from one arrangement to another. For purposes of this paper, however, it is more useful to consider the significance of these operations for the gold exchange standard.

The United States has described this network of swap arrangements as providing the resources to "counter speculative attacks on the dollar or to cushion market disturbances that threaten to become disorderly." (18). This description is sometimes understood to imply that the United States can support the dollar more effectively with foreign currency than with gold (19). This description is correct to

(18) William McChesney Martin, Jr., "Monetary Policy and International Payments", Federal Reserve Bank of New York, *Monthly Review*, January 1963, p. 13.

(19) The U.S. Treasury is committed to buying and selling gold in unlimited quantities in transactions with foreign monetary authorities for legitimate monetary uses at $35 an ounce plus or minus a handling charge of 3/4 cents an ounce (1/4 of one per cent). The cost of shipping gold to and from London is about 12 cents an ounce. The Bank of England will

the extent that foreign currency operations can reduce gold outflows as well as fluctuations of the exchange rate within the range set by gold points; but otherwise it is subject to serious question.

In conducting forward exchange operations, the U.S. monetary authorities engaged in what was, for them, relatively new activities. To buy dollars forward, the United States must have in hand, or have a firm way of acquiring, the foreign currencies it may have to deliver 90 days later. It can have this assurance by negotiating swap transactions, loans, or stand-by arrangements. It can do this equally well with gold, acquiring foreign currencies with spot sales of gold, or arranging to acquire them against forward sales.

Loans and swaps are thus substitutes for sales of gold. In this sense, the network of financial arrangements does not so much defend the dollar as defend U.S. holdings of gold.

From the point of view of the gold exchange standard, world reserves are increased when the United States obtains foreign currencies through swaps (20), loans, and debt repayments. They remain on this higher level until the United States (21) makes payments in these currencies to the respective countries. This procedure does not involve, and therefore may be said to " economize ", the use of gold. This follows from the universal practice of all countries to measure and report their international reserves on a gross basis, equating reserves to certain kinds of liquid assets regardless of counterpart liquid liabilities.

U.S. securities denominated in dollars or in foreign securities replace equivalent amounts of other dollar assets (demand and time deposits, bankers' acceptances, and the like) and thus do not affect the world total of international reserves. The securities denominated in dollars have two advantages to the owner, however, over securities purchased in the open market: they appear to have some slight interest advantage; and, more important, their price need not fluctuate in accordance with market interest rates.

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buy and sell dollars at limits of ¾ per cent either side of par. These limits are virtually equivalent to the U.S. gold points. This range could be reduced if the U.S. monetary authorities operated within it by buying and selling foreign currencies, but it could not be increased by such transactions. The range could also be reduced by reducing gold handling charges, but this would be more awkward and less flexible.

(20) Swaps of one currency for another increase the reserves of both countries.

(21) Or until third countries, to which the United States has transferred these currencies, pays them to the respective country of origin.

The securities denominated in foreign currencies constitute a new type of reserve asset. They are neither gold nor dollars. They are protected against devaluation of the dollar but not with a gold guarantee. They would not share the profits of a uniform change in the price of gold, i.e., a uniform change in the gold content of all currencies. From the point of view of the United States, securities denominated in foreign currencies are a substitute for gold; from the point of view of the holders, they are preferable to dollars. In recent months, new issues of securities denominated in foreign currencies have been rising, both absolutely and in relation to gold outflows, as shown by the following figures (millions) (22):

Increase in holding of securities denominated in foreign currencies	1962 3rd quarter	1962 4th quarter	1963 First five months
	$ 75	$149	$331
Outflows of gold	$555	$ 25	$220 (est.)

One commercial bank has commented that " Treasury plans for future operations of this nature indicate that these bond sales will become an increasingly important tool in the defense of the dollar and the international position of the United States. The Treasury also reports that negotiations are being carried on with almost every country that converted its dollar surplus into gold in 1962 " (23). There has been no official confirmation of these statements but it is clear that they are consistent with recent Treasury activities.

IV

A number of proposals which would further modify traditional operations under the gold exchange standard have been suggested in recent years. Mr. Reginald Maudling, Chancellor of the Exchequer in the United Kingdom, suggested at the Fund's Annual Meeting in September 1962 the creation of a Mutual Currency

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(22) Gold outflows, *International Financial Statistics*; security holdings, *Daily Statement of the United States Treasury*.

(23) First National Bank of Chicago, *Business & Economic Review*, May 1962. Only a few countries bought as much as $25 million of gold from the United States in 1962: Austria, Belgium, France, Spain, Switzerland, United Kingdom, and Lebanon. See *Federal Reserve Bulletin*, April 1963.

Account (24); Mr. Robert Roosa, Under Secretary of the Treasury of the United States, suggested that the United States was prepared, as a matter of policy, to hold convertible currencies as a part of its reserves (25). This implied that other major industrial countries should supplement their holdings of dollars and sterling with holdings of other convertible currencies (26). There have been a number of suggestions that the gold exchange standard based on two key currencies (dollars and sterling) be expanded into a multiple exchange standard operating with many currencies (27).

It is useful to consider these proposals — even though the first two have not yet been fully elaborated — from the point of view of the present operations of the Fund and of the potentialities of the Bretton Woods Agreement. This will throw into relief their similarities to the Fund and to each other, as well as their differences.

The Bretton Woods Agreement is very clear that the Fund consists of a pool of the currencies of all of its members; that a member uses the Fund's resources (draws) by obtaining any currency it needs in exchange for its own currency; and that a member is required to buy back its own currency (repurchase) when its reserve position improves. It can repurchase with any currency regarded by the Fund as convertible, i.e., as being under Article VIII, subject to the limitation that a member cannot tender currencies of which the Fund already holds 75 per cent of quota.

(24) *Summary Proceedings*, 1962, pp. 67-68.

(25) " Adding Foreign Exchange to Our Gold Reserves ", *Commercial and Financial Chronicle*, May 31, 1962, pp. 12-13; " Assuring the Free World's Liquidity ", *Business Review* (Supplement) of the Federal Reserve Bank of Philadelphia, September 1962.

(26) Thus, Mr. Roosa has referred to " a system where countries maintain some mutual holdings of foreign exchange " (" Adding Foreign Exchange to Our Gold Reserves ", *Commercial and Financial Chronicle*, May 31, 1962, p. 13). When the Federal Reserve System authorized open market transactions in foreign currencies, it noted that one objective was " in the long run, to provide a means whereby reciprocal holdings of foreign currencies may contribute to meeting needs for international liquidity " (*Federal Reserve Bulletin*, September 1962, p. 1151).

(27) For example, by F. Lutz in *The Problem of International Liquidity and the Multiple Currency Standard*, Princeton Essays in International Finance, No. 41 (1962). Compare the comment by E. M. Bernstein that " in a world in which the principal reserves are foreign exchange, two reserve centers are safer than one, provided both centers are strong. If only one currency is used as reserves, a flight from such a currency is most likely to be into gold; but if two currencies are used as reserves, a flight from either would be partly into the other currency... The world economy functions much better when two or more reserve centers are so strong that either can offset in considerable part the economic fluctuations originating in the other ". *International Effects of U.S. Economic Policy*, Study Paper No. 16 for the Joint Economic Committee, 86th Congress, 2nd Session (1960).

The Fund is thus an international institution established (to use terminology that is currently in vogue) to conduct swap transactions between its members in any direction, in any currency. These transactions are to be reversed automatically, as reserve positions improve, and in any event in not more than three to five years. A drawing from the Fund is a swap transaction in which the drawing member buys with its own currency that of some other member; a repurchase unwinds the swap transaction, in that the member is required to buy back its own currency with gold or some acceptable currency, not necessarily the currency it drew. These transactions are multilateral in two senses. First, the majority of Fund members must agree to each drawing (28). Second, the repurchase obligation of any member can be extinguished by the member itself, or it can be extinguished by other members to the extent that they draw the currency of the first drawing member.

The Fund can make swaps in large amounts, equal to a substantial fraction of its $15 billion of members' quotas. Since the Fund can also increase quotas (29), and supplement its resources by using its very wide borrowing powers (30), it can conduct swaps in virtually unlimited amounts, depending only upon the willingness of some members to draw and upon the willingness of other members to finance their balance of payments deficits.

It should be explicitly noted that the Fund was not set up as an international bank to deal only in key currencies. The Bretton Woods Agreement might have provided that the Fund would deal only with dollars and sterling, and perhaps a few other major currencies. Under such an arrangement, members could have deposited these currencies in the Fund and made settlements with each other by drawing checks on their deposits. They could, as now, have borrowed dollars, sterling, and other major currencies. In some

(28) The Fund formally operates on the basis of weighted voting. With some qualifications, each member has a number of votes related to the size of its quota. On the other hand, the formal counting of votes is rare. For a recent discussion of the Fund's organization and method of operations, see A. G. B. Fisher, " The Political Framework of an International Institution ", *Manchester School of Economic and Social Studies* (May 1962), pp. 132-139.

(29) Its Articles of Agreement provide (Article III, Section 2) that " the Fund shall at intervals of five years review, and if it deems it appropriate propose an adjustment of, the quotas of the members ".

(30) The $6 billion involved in the General Arrangements to Borrow (1962) is one example of these powers. Switzerland is in process of associating itself with these Arrangements to the extent of $200 million.

respects, the differences between this conception and the one adopted at Bretton Woods are formal; but in a number of important respects, the differences are great.

Until 1958, the Fund operated almost entirely on a dollar basis, and drawing and repayments were almost entirely made in dollars (31). Since then, the Fund has made increasing use of currencies other than dollars in financing drawings: 1958, 75 per cent; 1959, 77 per cent; 1960, 53 per cent; and 1961, 33 per cent. In February 1961, the currencies of the main industrial countries were made formally convertible under Article VIII of the Fund Agreement, with the result that they could be used in repurchases. In 1962, only 19 per cent of drawings, but 55 per cent of repurchases, were made in dollars. The percentage of drawings made in dollars would have been even lower if the United States had made a Fund drawing, necessarily in major European currencies, to finance part of its balance of payments deficit.

This conception of the Fund as a pool of currencies has been implemented by the Fund's "currency policy" with respect to drawings and repurchases (32). This policy rests on two propositions. First, though a member can support its own currency in foreign exchange markets with any convertible currency, it usually does so only or mainly with dollars, or in the case of sterling area countries, with sterling. Hence, the Fund understands in a multilateral sense the clause in the Bretton Woods Agreement that a member drawing a particular currency from the Fund must represent "that it is presently needed for making in that currency payments which are consistent with the provisions of this Agreement" (33). To do otherwise would be inconsistent with actual exchange practices under conditions of convertibility. Under such conditions, a member can use any convertible currency, though under conditions characterized by bilateralism a member might only draw some specific currency. Second, the choice of currencies to be used in making drawings and repayments should, as far as possible, offset movements of funds in exchange markets, thus promoting exchange stability and strengthening international payments operations. This implies that, to

(31) Ninety per cent of the $2.9 billion of drawings in the years 1947-58 were made in U.S. dollars.

(32) *Annual Report*, 1962, pp. 36-41.

(33) Article V, Section 3(a).

the maximum extent possible, members will draw currencies that are strong in the exchange markets, and that they will repurchase in currencies that are weak in these markets. The Fund outlined its criteria more broadly in the following words:

> ... account has been taken of the balance of payments and reserve positions of the countries whose currencies are considered for drawing, as well as of the Fund's holdings of these currencies.
>
> It has been found in practice that weight has to be given to all of these three considerations, with some differentiation according to specific circumstances, and perhaps most particularly according to the size of the transaction or transactions involved (34).

Carrying out these principles in specific cases involves detailed and sometimes difficult decisions with respect to the reserves of particular countries and developments in their balance of payments.

Changes in members' creditor positions in the Fund show how this principle was carried out. In December 1959, the United States had a creditor position of $970 million (35). By February 1963, Fund holdings of dollors had increased to 74 per cent of the U.S. quota because members repurchased their own currencies with dollars. Consequently, the United States had virtually a neutral position. At the same time, substantial creditor positions were held by Belgium, France, Germany, Italy, the Netherlands, and Japan, whose currencies had been drawn by other members.

Though under present conditions a member can use any convertible currency in exchange markets to defend its own currency, in practice the countries outside the sterling area use dollars principally or exclusively for this purpose. A bridge is therefore required between the non-dollar, non-sterling currencies that members draw from the Fund and the currencies they actually use in exchange operations. This bridge is provided by the arrangement that a member drawing (say) Italian lire can ask to have those lire converted into dollars by the Italian monetary authorities. The combined effect of the drawing and conversion is, therefore, that the drawing member obtains dollars; Italy's official holdings of dollars are re-

(34) *Annual Report*, 1962, p. 38.

(35) The Fund's holdings of dollars were $970 million less than the $3.1 billion of dollars that the United States had paid in, i.e., 75 per cent of the U.S. quota of $4.1 billion, because other members had purchased dollars with their own currencies.

duced; the Fund's holdings of lire are reduced; and Italy acquires a creditor position in the Fund to the extent of this reduction.

A member's creditor position is a component of its gold tranche; and in drawing within the gold tranche, a member is entitled to the " overwhelming benefit of the doubt ". This asset of the member is anchored to a gold base. To continue the illustration used above, if Italy wishes to draw dollars to the extent of its creditor position, and the dollar has been devalued in the meantime, Italy will obtain more dollars than it paid out originally to convert the drawing of lire. In other words, Italy was protected against the devaluation of the dollar. A creditor position in the Fund and a balance in a bank account are thus not the same, though some of their differences are minor. Each has certain particular advantages.

The preceding discussion, which is perhaps unnecessarily detailed, is suggested by the peculiarities of the terms used to describe the Fund's operations and the complexities of its Articles of Agreement. These Articles are indeed complex, partly because they cover a wide range of operations and commitments, and partly because these commitments are unlimited in time. Members can lay them down only by withdrawing from the Fund.

This discussion makes it possible to compare with more accuracy than would otherwise be possible, the operations of the Fund with those of some plans proposed for improving the operations of the gold exchange standard, and also to compare these plans with each other.

The Maudling Plan for a Mutual Currency Account has not yet been published officially but a number of published articles have dealt with it (36). Membership in the Mutual Currency Account would be limited to the major industrial countries. Operations would begin when country A acquired a credit in the Account by depositing currency of country B obtained through exchange operations after the Plan was put into effect. This initial deposit would require the consent of both countries, since A would have to be satisfied

(36) *The Economist*, September 22, 1962, pp. 1123-1124; " Mr. Maudling's Initiative ", *The Banker*, October 1962, pp. 632-638; Fred Hirsch, " International Credit — Needless Discord ", *ibid.*, November 1962, pp. 700-706, and Sir Ralph Hawtrey, " Too Little Liquidity — or Too Much ", *ibid.*, pp. 707-712; " Back to the Keynes Plan ", and " Cold Shoulder for Maudling ", *The Statist*, September 28, 1962, pp. 874-875 and 889-890; and Paul Barbau, " The Roosa Plan and the Maudling Initiative ", *ibid.*, January 11, 1963, pp. 109-111.

with its new reserve asset, and B would be committed to maintain the value of its currency so deposited at its gold equivalent value. The transaction would create an asset which A could add to its reserves, but would not reduce B's reserves of gold and foreign exchange. When A wanted to use its asset, because it in turn had developed a balance of payments deficit, it could reverse its transaction with B, or arrange a transaction with C. Under this A-C transaction, C would deposit A's currency, and A would obtain C's currency or the currency of some other member that it needed at the time. This transaction would net out A's creditor position in the Account, and C would replace A as a creditor to the amount of the A-C transaction. These operations are conceived to be multilateral in spirit and character and to be reversible in relatively short periods.

The usability of a deposit in the Mutual Currency Account depends upon the ability of a depositor to find another country that is willing to take over its deposit. As will be observed below, this is the same problem that would confront any country that wished to spend some particular currency holding under the Roosa Plan and similar arrangements. If depositor A can use its deposit at any time, without embarassment, or limitation, or explanation, its deposit is, so to say, international legal tender. In these circumstances, it can be used in the same way as dollars, sterling, and, by a somewhat different technique, gold tranche positions in the Fund, are used now. The dollar and sterling have attained, or have been accorded, their key currency status by general consent; and such status is a prerequisite to their widespread use in a gold exchange standard. This status reflects the ability of holders of dollars and sterling to use them at any time, regardless of whether the United States and the United Kingdom are in balance of payments surplus or deficit. To create approximately the same status for deposits in the Mutual Currency Account requires particular provisions, including: 1) a limit on the size of the Account, that is, a limit on the deposits of any member's currency and on the size of the creditor position that any member can be asked to assume (37); 2) a gold guarantee with respect to currencies deposited in the Account; and 3) an

(37) In its simplest form, this limit for any depositor is equal to the maximum amounts of currencies of all other members that may be deposited.

assurance, more or less unqualified, that when a depositor wishes to use his asset, other members will be willing to accept it.

The Mutual Currency Account thus differs from the International Monetary Fund in that its membership is restricted, its size is very much smaller (38), and its operations have less of a multilateral, and more of a bilateral, character. In both, debtor and creditor positions are linked to gold. To the extent that the Mutual Currency Account can provide an unqualified assurance that any deposit can be spent (i.e., transferred) when it is needed, it will have to function as does the IMF, which makes it possible for any member with a creditor position to draw the currencies it needs without qualification or restriction.

The Mutual Currency Account could perhaps operate differently from the IMF if it were small. If it became large, it would have to operate like the IMF, with a currency policy on drawings and repurchases.

The Roosa Plan, as described to date, assumes that the United States, which already holds some foreign currencies as a result of its borrowings and swap transactions, would acquire much larger holdings when it could earn them through a balance of payments surplus. In accordance with the Plan, the United States would accept foreign currencies in place of gold and dollars to a substantial though undisclosed extent in settlement of future balance of payments surpluses. Correspondingly, foreign countries would be able to settle part of their balance of payments deficits with the United States in their own currencies. Most other industrial countries would be expected to act in corresponding fashion, holding a wide variety of convertible currencies in their international monetary reserves. They might hold a larger proportion of dollars in their reserves than they do presently, and they might also hold more currencies (39). These mutual currency holdings would increase international liquidity. If, for example, Germany settles half of its balance of payments deficit with other countries in deutsche mark, its reserves of gold and

(38) One figure often mentioned for all members is $1.5 billion. This figure would undoubtedly be increased if the Mutual Currency Account operated successfully.

(39) There have been a number of other proposals in recent years to increase the number of currencies held as exchange reserves. Some involve gold guarantees for the exchange holdings of monetary authorities; others do not. The Posthuma Plan involves a multiple currency standard with gold guarantees combined with some agreed proportion between holdings of gold and those of foreign exchange. This proportion could be changed from time to time, by agreement, in accordance with world needs for international liquidity.

dollars would decrease only half as much as they otherwise would; on the other hand, the surplus countries would increase their own reserves, half in deutsche mark, and half in gold, dollars, and sterling (40). It remains an open question whether Germany will act differently to correct its balance of payments deficit if it settles part of this in deutsche mark.

Operations under the Roosa Plan have, in many respects, the same effects as transactions with the Fund. Swap operations (drawings under reciprocal currency agreements) may be considered first. Swaps are bilateral but a swap with any country nevertheless reflects the general knowledge that the United States has negotiated, or intends to negotiate, swaps with other countries. The size of the swap transaction(s) with particular countries is not developed in isolation. Hence, there is necessarily a multilateral aspect to these bilateral transactions. Drawings under all swap arrangements were about $600 million through January 1963 (41), or about half of the $1.1 billion that the United States could have drawn from the Fund in the gold tranche with " the overwhelming benefit of the doubt ". This is not an argument that the United States should have drawn on the Fund. There may have been particular reasons, reflecting technical or public relations considerations, that made swap transactions preferable to a Fund drawing (42). The economic effects would, however, have been virtually the same.

This will also be the case in the succeeding period when it is assumed that the United States has a balance of payments surplus and accepts foreign currencies in part payment of it. If this financing were handled through the Fund, other countries, for example, Germany, would draw dollars from the Fund and pay these to the United States; the Fund would hold the deutsche mark that otherwise would be paid to the United States. The difference between financing under the Roosa Plan and drawing on the Fund is that the United States will hold deutsche mark rather than a creditor position

(40) Unless, of course, the dollars are paid to U.S. monetary authorities or residents, and the sterling is paid to the United Kingdom.

(41) Charles A. Coombs, " Treasury and Federal Reserve Exchange Operations ", Federal Reserve Bank of New York, *Monthly Review*, March 1963, p. 39. This brought up to date an earlier report in the issue of October 1962.

(42) The U.S. authorities may perhaps have considered that even sizable drawings under the swap arrangements would not decrease the ability of the United States to draw from the Fund. There is no doubt that they preserved intact the ability of the United States to draw its gold tranche with " the overwhelming benefit of the doubt ".

in the Fund. If the United States counted its creditor position (43) in the Fund as a reserve asset, its gross reserves would be exactly the same as if it had been paid in deutsche mark.

Are U.S. holdings of deutsche mark a better reserve asset than a creditor position in the Fund? The difference is not important as long as the United States continues to have a balance of payments surplus (44). It may become important when the United States has a balance of payments deficit, and wishes to spend deutsche mark. If at that time Germany also has a balance of payments deficit, the United States may have difficulty in paying its holdings of deutsche mark to a third country, which may wish to convert them into another currency or use them to buy gold. Before spending deutsche mark under these conditions, the United States may wish to consult Germany, and also third countries, in order to make certain that its payments in deutsche mark will not embarrass Germany. Under such conditions, the unconditional usability of deutsche mark as a reserve asset cannot be taken for granted.

Under the Roosa Plan, countries can operate with exchange reserves consisting of many currencies only if all countries together act as they now do collectively in the IMF, or if the United States is willing to act unilaterally, on a large scale, like the IMF in acquiring and spending currencies other than the dollar. When the United States has a balance of payments surplus, it will acquire the currencies of countries in deficit, presumably on the assumption that these deficits will not be too large and that they will be eliminated, if not reversed. On the other hand, the United States will finance its deficits with the currencies of countries which are in surplus at the time, as well as with payments of gold and dollars. If the United States acts otherwise, a country that meets a balance of payments deficit with its own currency cannot be sure that at some future time it may not have to use its holdings of gold, dollars, and sterling to finance both its current deficit and pay up (i.e., convert) its past deficits. Faced with such a contingency, it may well prefer to finance deficits as they come along with its holdings of gold, dollars, and

(43) Or its gold tranche, which includes its creditor position.

(44) It should be noted that the value of a creditor position in the Fund is maintained in terms of gold. This would be important if, in the illustration given, the deutsche mark were devalued.

sterling, or with currencies obtained by drawing on the Fund. Such a decision may have the advantage of emphasizing the need to correct balance of payments deficits as they occur.

V

The ability to create assets having an international character, and thus to expand the supply of international liquidity, implied by the Roosa Plan, the Maudling Plan, and proposals for a multiple currency standard, is no different from the ability of the IMF to do the same thing. This ability rests fundamentally upon the willingness of countries with a balance of payments surplus to accept payment for all or part of their surplus in particular kinds of assets, i.e., short-term, medium-term, or long-term liabilities of deficit countries. Creditor countries may hold these liabilities directly, or they may do so indirectly, in the form of liabilities of an international agency whose assets in turn are, mainly or wholly, the liabilities of deficit countries (45).

All proposals for managing or increasing the supply of liquidity rest upon this basic identity. Only the combination of instruments varies.

The swaps undertaken by the United States in the past two years have been swaps of money for money, with the transactions reversible in three months. More recently, many swaps have been funded, so that the transactions have been converted into swaps of foreign currencies for term obligations of the United States having a maturity up to two years, stated in dollars or in foreign currencies.

Drawings from the Fund are swaps of money, with the transaction to be reversed, as far as the debtor is concerned, in a maximum of 3-5 years (46). In these cases, the Fund, which holds assets in all currencies, acts as an independent party; the total of its assets and liabilities does not change, though the members with debtor and creditor positions change. Moreover, the reserves of the drawing

(45) For a general survey of the credit mechanisms involved in many plans for international financial improvement or reform, see Fritz Machlup, *Plans for Reform of the International Monetary System*, Princeton Special Papers in International Economics, No. 3, August 1962.

(46) The creditor could, of course, reverse the transaction whenever necessary.

country increase because it receives convertible currency, while those of the country whose currency is drawn may also increase (47).

The Maudling Plan is a swap of a currency for a credit certificate issued by the Mutual Currency Account. The Account in effect acts as an agent and does not need capital funds of its own. The claim of a depositor is represented by a certificate of deposit issued by the Account but it is not a claim on the Account. The depositor cannot obtain gold or other currencies from the Account by cashing its certificate. Nevertheless, a depositor that develops a balance of payments deficit can in effect transfer its creditor position to a member which is then in surplus. The value of the Account to each member lies precisely in the undertaking by all members that they will act in this way. The attractiveness of certificates is enhanced by their gold value clause; this, in turn, rests upon the obligation of each country to maintain the gold value of all of its currency which has been deposited in the Account.

A supranational central bank designed to create and manage international liquidity is like the present Fund in swapping an asset for an asset; but in this arrangement the central banks assets (i.e., the countries' liabilities) would probably have a long-term character (48). Deposits held by member countries in such an international central bank (i.e., the liabilities of the bank) might be denominated in an international money of account (" bancor ") tied to gold, but would have to be converted into currencies which countries could use in their foreign exchange market operations. This is also the case with a member's creditor position in the Fund.

The similarity of the Roosa Plan and the Maudling Plan to the International Monetary Fund does not imply that these Plans are unnecessary. It may rather imply consistency and flexibility in

(47) To the extent that this country obtains a creditor position in the Fund (i.e., the Fund's holdings of its currency are reduced below 75 per cent of its quota) and includes this in its reserves.

(48) There have been many proposals of this type in the last few years. The most recent was made by Mr. Harold Wilson, leader of the Opposition Labor Party in the United Kingdom, who suggested that the International Monetary Fund issue credit-creating gold certificates, using these to " buy Government obligations of any country, thus increasing its gold reserves and enabling it to expand — as long as there are unemployed resources... These certificates would be used by the country receiving them to meet its balance-of-payments deficit. The result would be to increase the total liquidity of the non-Soviet world and to end all possibility of a shortage, while at the same time sustaining demand ". (*New York Times*, May 16, 1963).

actual operations. This similarity could create deeper, though not necessarily broader, defenses in the international financial system. As such they could function more effectively in the knowledge that they are backstopped by the Fund.

The rapidity of decision with respect to the $900 million of commitments under the Basle Agreement was undoubtedly influenced by the understanding that this financing was short term in character, precisely because it could be (and, in fact, was) refinanced by a U.K. drawing on the Fund. The short-term loan to the United Kingdom of $250 million in the first quarter of 1963 by several European central banks could, in the same way, be repaid by a U.K. drawing under its Fund stand-by (49). Extensive facilities of the same sort are provided by the network of stand-by swap arrangements, under which drawings can be made by either party quietly and rapidly. The value of these facilities was underlined at the end of May 1963 when the dollar-sterling stand-by was increased from $50 million to $500 million.

Recognizing that the Roosa Plan and the Maudling Mutual Currency Account are very similar in their operations to the Fund makes it possible to use them, or some modifications of them, as instruments of first resort. It is possible, therefore, that the interrelationship of these operations with the Fund would make the total system more sensitive and more flexible. On the other hand, these advantages are greatly reduced if the same countries are willing to use the Fund's resources flexibly for small amounts as well as large, concurrently with their use of their own resources, and if they are willing to consider their creditor positions in the Fund as part of their published reserves. Under these circumstances, the proliferation of agencies and techniques to accomplish virtually the same thing may lead to inefficiency and political misgivings.

Washington OSCAR L. ALTMAN

(49) Cf. the reports in the *New York Times*, April 24 and May 3, 1963. The United Kingdom currently has a stand-by of $1 billion.